

Note of Ofgem's workshop on assessing strategic and sustainability considerations in our decision making

This is a record of Ofgem's "Assessing strategic and sustainability considerations" workshop, held 25 October 2012.	From Date and time of Meeting Location	Jenny Mills 25 October 2012 9:30-12:00 BIS Conference Centre
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1. Present

Industry attendees

Richard Wallace (Centrica)
David Watson (Centrica)
Matthew Brown (Confederation of British Industry)
Jane Cooper (DONG Energy)
Ravi Baga (EDF Energy)
Bindi Patel (Energy UK)
Lewis Dale (National Grid)
Steve Marland (National Grid)
Paul Rogers (National Grid)
Stephen Parker (Northern Gas)
Zoltan Zavody (RenewableUK)
Jill Brown (RWE npower)
Joanna Alexander (SmartestEnergy)
Aileen McLeod (SSE)
Steven Edwards (Wales and West Utilities)

Ofgem staff

James Luger (Chair)
Sarah Harrison (Speaker)
Michael Grubb (Speaker)
Sabreena Juneja
Natasha Smith
Rhianne Ogilvie
Stefan Bojanowski
Jennifer Mills

2. Welcome and scene setting

Sarah Harrison – Senior Partner, Sustainable Development Division, Ofgem

2.1. Sarah Harrison welcomed delegates to the event, and provided an overview of how changes to the Energy and Gas Acts (and more recently the EU Third Package) have led to an increasing emphasis on strategic and sustainability issues within regulatory decision making. The evolving nature of our statutory duties has in turn led us to consider how to consider these complex, interrelated issues (including the interests of future consumers) in our policy development.

2.2. Consequently, we set out to develop proposals for how we consider strategic and sustainability issues in support of our decision making. Our aim in doing this is to bring greater transparency and consistency to our treatment of complex, long-run issues.

2.3. We set out our initial thinking in our discussion paper¹ published in June 2012, and many of your organisations responded to those proposals. We have also consulted with the academic community, NGOs and government departments.

2.4. We are setting out our proposals for a more systematic, structured approach to the way in which we consider the strategic and sustainability dimensions of major decisions. In practice, we intend to embed these strategic and sustainability considerations into our Impact Assessment (IA) framework, where they will add to the range of tools we use – including CBA and distributional impact assessment – to test our policy options and thinking.

2.5. At this stage in the process we are identifying *what* the considerations in our assessment should be, and *how* they should be applied, so we are taking this opportunity to ask industry if these are the right issues and if anything is missing.

2.6. The proposed considerations are not determinative – GEMA will weigh these issues alongside others – but they should yield transparency and consistency benefits, both for external industry participants and for our internal decision making.

2.7. Looking ahead, we anticipate further changes to our remit in the shape of the new Energy Bill, and its clauses relating to the Strategy and Policy Statement (SPS). The SPS is expected to clarify the respective roles of Ofgem and government and identify policy outcomes that we must have regard to. Whilst this will help to address the issue of 'weighting' in our decision making, we will still need a means of considering complex issues in a systematic and transparent manner, and today is a key next step in helping us develop that approach.

Matthew Brown – Head of Climate Change and Energy, CBI

2.8. Matthew Brown explained that the CBI's key objective is to maximise GB growth potential, and that this is linked to energy in a number of ways. First, business is underpinned by the ability to obtain secure energy supplies at an internationally competitive price. Second, that there are risks and adaptation challenges associated with decarbonisation. Third, that there are also significant opportunities. The CBI's recent report, "The Colour of Growth", argues that green initiatives can drive growth if they are implemented in a 'smart' manner'. If approached in the right way risks can be minimised, and the billions of pounds of investment that will be going into the energy system in the coming years represents significant opportunities for GB businesses.

2.9. However, for the average business the key issue regarding energy is future costs: according to the most recent annual CBI infrastructure survey, 95% of businesses are concerned about energy prices. The main reasons for this concern are linked to the volatility of fossil fuel imports, and the costs of energy-related investments. We can't do much to control the importing of fossil fuels, but we can exert influence over the investments we pay for. Ofgem's role is to regulate this interaction. It is a big task to consider the impact of their decisions, with a lot to lose but with a big prize. It is in industry's interests to help Ofgem get the answers right.

3. Assessing strategic and sustainability considerations: our proposals

3.1. Professor Michael Grubb presented Ofgem's proposals, explaining a conceptual framework with 'optionality' and 'diversity and resilience' components feeding into an assessment of 'stress and security implications', and 'learning by doing and supply chain development' and 'pathways and lock-in' components feeding into an assessment of

¹ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=56&refer=Sustainability>

'natural asset and sustainability implications'. He also raised several points beyond the scope of the presentation, namely:

- In considering issues out to 2050, the choice of discount rate becomes critical. A discount rate of 1% makes a decision very important, whilst 5% makes it irrelevant.
- How might consumers' reactions be included in this assessment? Might behavioural economics help with insights into consumer reactions?

3.2. James Luger then opened the floor to questions.

3.3. A question was raised as to whether there is scope to add a 'leadership' element to the framework, such that network regulation generates industry confidence and paves the way for the development of a low-carbon economy rather than reacting to current need. Similarly to the international stage, the benefits of GB policy are not only about immediately attributable savings but also about the knock-on impacts on market development. Ofgem's response was that this is an important issue for the UK energy strategy but national / international influencing is a role for government and Parliament, not Ofgem. However, the secure, sustainable and affordable energy that this framework promotes is entirely compatible with current economic and political imperatives.

3.4. Building on this theme, some participants suggested that an ambitious, transformative vision of a sustainable energy system was needed if a sustainability assessment is to be effective. Ofgem responded that legislated targets are about providing a vision, and the strategic and sustainability considerations aim to help clarify whether our decisions are consistent with meeting that vision.

3.5. One participant questioned the 'explicit considerations' featured in the presentation, and whether the intention is to set these out in the Impact Assessment, with additional guidance on how they have been evaluated. Ofgem's response was that we have not yet fully worked through how the assessment will be operationalised, although the technical annex of the discussion paper gives a sense of how we will assess some of the components. The IA framework must be both proportional and realistic. The approach can therefore vary on a case by case basis, and we do not want to over-specify the issues we will address.

3.6. The issue of double counting environmental and GHG assessments was raised, particularly for those areas already assessed by government departments or other regulatory authorities. Ofgem's response was that our role is to accept those assessments but we are still required to consider whether the original assessment is fit for purpose in a new context, and also whether cumulative or combination effects may arise.

3.7. A participant questioned how the framework can be transparent enough on qualitative considerations, as the decision will ultimately come down to the judgement of whoever is making the decision. Ofgem responded that the same is true of any IA process. An IA is deemed to be adequate if the decision is sufficiently justified, and the evidence transparently presented. If people disagree with the decision, there is a process through which it can be reviewed and challenged. Our purpose is to improve the transparency of this process for complex, long-long run issues.

3.8. A question was asked whether the framework had been set up to balance consideration of both risks and opportunities. Ofgem responded that the framework should illuminate both, helping to present a balanced case to decision-makers.

4. Table discussion and plenary

4.1. James Luger opened the table discussions by drawing out the key points that were raised in responses to our discussion paper. These included:

- **Thresholds and triggers** – Defining “significant impacts” / thresholds and triggers for IA purposes
- **Transparency of process** – eg relative weighting of issues, optionality, industry interactions with IA processes
- **Integration with other policy makers' policies / processes** – eg avoidance of double-counting of an asset's environmental impact
- **Implications for industry processes** – eg code modification panels, industry technical groups
- **Incorporating GHG emissions implications**– eg EU emissions trading, cumulative carbon
- **Temporal considerations** – Clarifying mid-term and long term, looking beyond 2050
- **Adaptation to climate change / natural environment and energy system 'resilience'**
- **Consumer considerations** – Wider social welfare vs. consumer welfare, and insights from behavioural economics

4.2. Meeting participants then split into three table discussions lasting 45 minutes, before reporting back to the wider group.

4.3. *Key points raised in discussion:*

- Participants were broadly supportive of the framework's principles
- There needs to be further thought about what will trigger the application of the framework / IA
- Participants requested more information about how it will work in practice, particularly in terms of its relative weight in decisions taken by the Gas and Electricity Markets Authority
- Will adding to the IA make the decision making process more arduous/resource intensive instead of enabling better decisions?
- The current framing could be more neutral rather than risk-based (balancing opportunities with risks)
- Wider considerations should include the direct costs of delays and uncertainty, including the impact of loss of confidence and momentum by the wider energy industry in working towards long-term sustainability goals
- The framework should be used proportionately, with more significant consideration in bigger decisions; there are some areas of policy making where it may not be necessary
- There should be continued collaboration during the process to ensure that the frameworks considerations are properly embedded in regulator / industry interactions
- This represents a large cultural shift, and therefore needs buy-in from industry, government and across Ofgem.

5. Next steps

5.1. James Luger set out the next steps of the process, including continued informal consultation with industry, internal trials and a formal consultation on our Impact Assessment guidelines.

5.2. Ofgem emphasised that participants are welcome to contact sustainable.energy@ofgem.gov.uk if they would like to further discuss any of the issues raised by the proposals.