Scotia Gas Networks

SSE

Inveralmond House
200 Dunkeld Road
Perth PH1 3AQ

Hannah Nixon
Ofgem
9 Millbank
London
SW1P 3GE

Tel: 01738 456712

15 January 2012

Dear Hannah,

Consultation letter: Joint Regulators Group (JRG) work considering possible impacts of regulatory frameworks on opportunities to coordinate infrastructure work across sectors.

Thank you for your letter dated 23 November 2012. This response is submitted on behalf of SSE and SGN, who have interests in the generation, transmission, distribution and supply of electricity; the production, storage, distribution and supply of gas; provision of water and sewage services; and the provision of telecommunications network and retail services. As such the issues raised in the consultation letter are particularly relevant. Both companies have significant interest in and experience of many of the issues raised. While challenging, we believe there is scope for better planning, coordination and regulation of activities across sectors to improve efficiency and reduce cost, particularly in relation to network investment and infrastructure planning. While we appreciate the letter suggests the focus should be to address issues across two or more sectors, we believe most of the obstacles that we currently face are with one sector e.g. between electricity and gas; between distribution and transmission (electricity and gas); or between networks and supply. In a few instances they may also be between two sectors e.g. between energy and rail; between energy and water; or between energy and telecommunications. As such, we suggest within sector should be the main focus of attention going forward.

We believe most of the issues that currently arise are a result of activities being licensed under separate legal instruments e.g. The Gas Act or the Electricity Act. Permitted activities under the relevant Act and associated licensing regime are then set out and defined in a very narrow and prescriptive way. Even within a specific sector e.g. electricity the role of transmission and distribution are separately provided for and licensed. There is limited scope for flexibility across the regulated boundaries. This means investment decisions; costs, benefits and revenues are considered in the same way. While wider benefits may be identified and considered in the development and consultation process there is very limited scope within the legal and regulatory framework for costs or revenue to be shared. As a result, wider benefits do not drive the decision making process.

The timing of events across sectors can also act as a deterrent e.g. price control reviews are often conducted at different times making it difficult to plan and coordinate investment and funding decisions across different activities or sectors.

While we do not believe existing frameworks necessarily discourage sharing or coordination, we believe the legal and regulatory framework could be enhanced to include the necessary mechanisms and incentives to facilitate a joint approach and to deliver wider benefits. To help move things on we have provided some examples below of instances where we believe a coordinated approach has helped deliver improvements and instances where we believe further focus is required.

Areas that have benefited from industry coordination

Network Planning and Investment
There are many areas within the energy sector where coordination and sharing of information has delivered wider benefits, particularly where there are long lead times e.g. electricity and gas network planning and demand forecasting. This has helped improve efficiency of network investment and operation and delivered benefits for customers in terms of security of supply and reduced cost. Additional benefits have also been realised where details are shared more widely e.g. with local authorities, transport and other utilities to allow wider planning and coordination of activities, reduce cost and minimise disruption for customers. However SSE and SGN recognise there is still scope for further improvement. We believe there is still a need for greater consistency and coordination of approach, particularly across sectors and appropriate incentives are required to drive the correct behaviour.

RIIO
The new RIIO regulatory framework has also driven improvements, placing greater emphasis on wider stakeholder engagement, innovation and cost benefit analysis; ensuring investment decisions meet the needs of current and future customers and deliver specific benefits that will be monitored and measured within the energy sector throughout the price control period. It also introduces a new innovation stimulus package that provides funding for specific network projects that will help facilitate the transition to a low carbon economy and encourage greater involvement from third parties.

Areas where further work is required

Licensing Regime
As set out above, the licensing regime and associated funding arrangements are very focused on requirements within individual business areas, permitted activities and proving net financial benefit within these individual areas. This often constrains the extent to which a different approach can be adopted and wider costs and benefits recognised. In particular there is limited ability to transfer costs or revenues between activities or businesses or to take account of wider costs or benefits in the decision making process, particularly where different sectors fall under different regulators. In such cases the benefits of clarity and certainty offered by the current regulatory framework can act as a deterrent as there is very little flexibility. We believe greater flexibility is required across regulatory boundaries, particular in relation to consideration and apportionment of costs and benefits.

Innovation
The innovation funding arrangements that apply to gas and electricity network operators have been designed to help networks address some of the challenges they face in the transition to a low carbon economy. The arrangements encourage wider stakeholder engagement and third party involvement to maximise innovation, information sharing and new sources of funding. However the regulatory environment in which networks operate is very different to that which most third parties are used to. Initial experience has shown that third parties can struggle with the fact that it does not provide the level of flexibility that normally exists in a commercial environment, particularly given the uncertain nature of innovation projects.

It can also be quite difficult to quantify and apportion costs or benefits across the full range of activities, regulated businesses or sectors. The focus on providing net benefit in each sector in order to secure funding and prevent cross subsidy can act as a deterrent particularly when combined with restrictions that prevent sharing or transfer of costs and revenues. Wider customer benefits within or across sectors can be ignored or lost as a result. This needs to be addressed to prevent sub optimal decisions being made.

Sharing of Infrastructure
This is extremely difficult given the current legal and regulatory framework. A number of barriers have been identified recently particularly in relation to the communications infrastructure e.g. use of electricity network infrastructure to support fibre optic cables or the use of power line communications technology to support smart metering solutions. Potential barriers can exist, again in relation to restrictions introduced through the legal and regulatory framework relating to permitted activities and rights that may prevent network operators granting other parties or utilities right of access to assets, consents or wayleaves. Other restrictions may also apply in relation to operational control and safety obligations.

Sharing Costs and Revenues
As the licensing regime relates to very specific objectives and activities, this can prevent wider sharing of costs or revenues across a number of entities or sectors. While it is important that the regulatory framework endeavours to ensure costs are targeted at those whose behaviour drives costs and are best placed to manage them, to ensure appropriate signals and incentives exist, in some cases a pragmatic approach may be required in order to recognise and deliver wider benefits or outcomes. This has been a particular issue for discussion across the energy sector in relation to smart metering costs.

We are concerned there also seems to be a lack of consistency of approach across regulated sectors. While the energy sector seems to be focused on cost targeting, our experience with rail through the project to electrify the rail network has resulted in significant and unexpected costs being incurred by electricity distribution network operators to move lines under the master wayleave agreement. The wider impact across different regulated sectors and the wider impact on electricity distribution network operators and network customers in particular should have been a key consideration in the decision making process. All costs and benefits should be taken into account and appropriately targeted and recovered, to ensure no detrimental impact on one party relative to another. At present there is no mechanism for electricity distribution network operators to recover these costs and as they have not been targeted at the relevant sector i.e. rail users, we are concerned this may distort the decision making process.

Best Practice
We believe there is still significant scope to identify and share best practice across sectors and regulated activities in a number of areas e.g. safety, operational practices, planning, charging, stakeholder engagement etc. We believe there is a need for a forum at senior management and working level across sectors to achieve this.

We hope our comments are helpful.

Yours sincerely

Beverley Grubb
Regulation Manager