

Electricity and gas experience
with constructive engagement/
negotiated settlements
around the world and their
applicability to the UK

Stephen Littlechild
Imperial College Workshop
20 December 2012

Outline

- UK & US regulatory history and framework
- Negotiated settlements in Florida, NEB Canada, FERC and Texas transmission
- Argentina: the Public Contest method in electricity transmission
- Australia: airports and one railroad
- Conclusions: implications for UK

UK regulatory history & framework

- Privatisation → regulation? Or CC appeal?
- Regulatory decision-maker
- What process for regulator to make informed & timely decision?
- Many merits & successes, incentives etc
- Also limitations: information access & understanding, representation, confrontational, burdensome, constrained, uncertain – are there better approaches?

US regulatory approach

- Regulated company or regulator has to apply for change in authorised rates
- Case argued before Admin Law Judge
- Other parties also give evidence
- Including regulatory Staff
- ALJ decides & recommends to regulator
- Regulator makes final decision
 - Note similarity to role of CC in UK utility regulation
- Time-consuming, costly, uncertain process

Negotiated settlements

- But parties have overcome these disadvantages: negotiated settlements
- Company & parties negotiate, try to agree & propose settlement to ALJ, who conveys it to regulator, typically accepts if all agree
- Regulatory process resumes if not
- Less time, cost & uncertainty
- Offers possibility of innovative outcomes

Regulatory issues

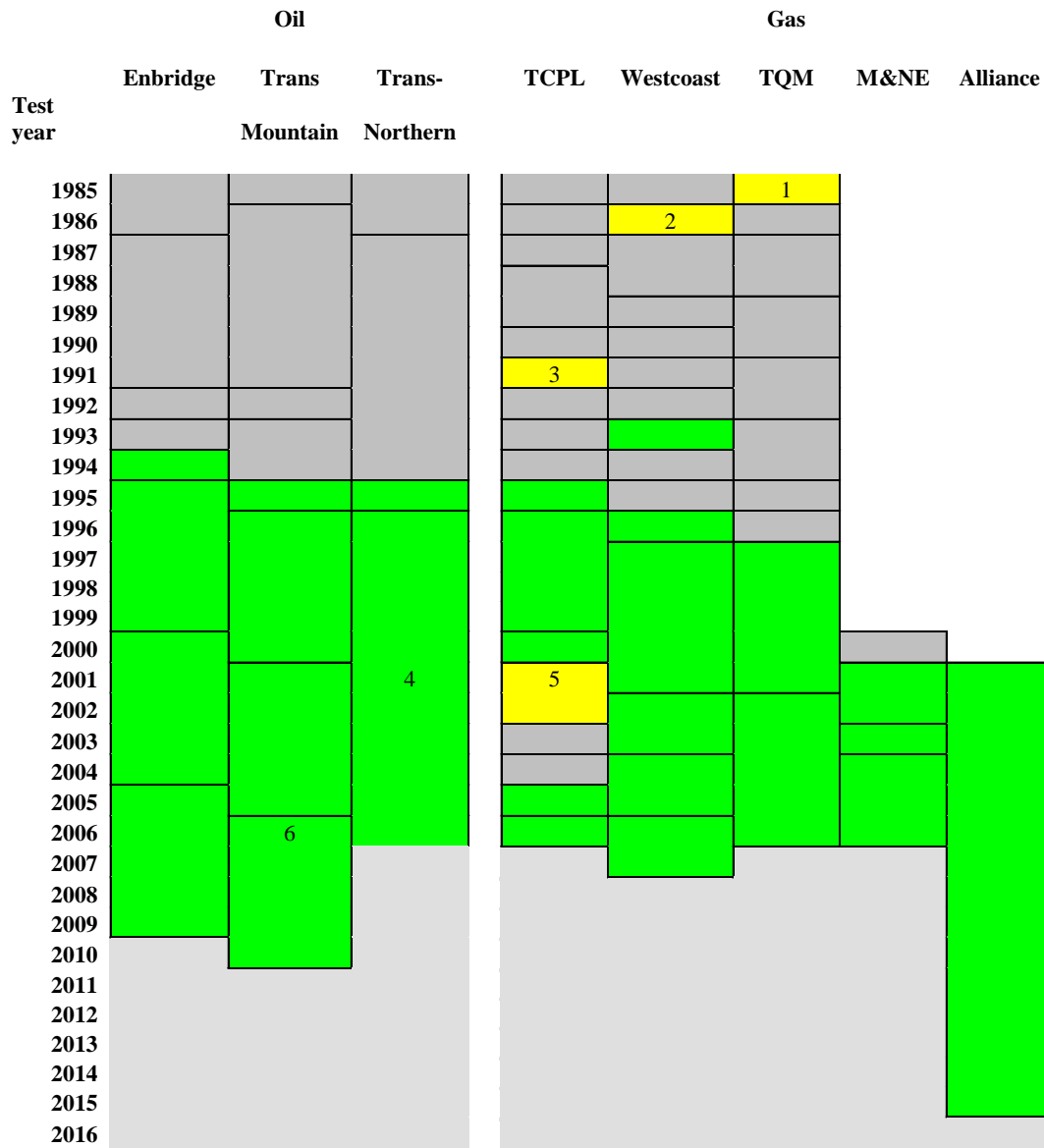
- Are settlements always a good thing?
- Who needs to be involved?
- Provision for wider public interest?
- Provisions for exchanging information?
- Role of regulator: passive or active?
- How far to structure the process?
- Provisions in event of failure to agree?
- Examine a variety of different approaches

Consumer advocate in Florida

- Consumer advocate (Public Counsel) has negotiated settlements with utilities 1990s
- Independent initiative, no role for regulator
- Customers preferred outcomes
 - Electricity rate reductions \$4bn vs more reserves
- Innovative: utilities got revenue-sharing price freezes, not rate of return control

Pipelines in Canada

- Before: National Energy Board long hearings
- 1990s NEB keen to deregulate
 - Set cost of capital formula to aid negotiation
 - Encouraged negotiated settlements
- Policy: if process sound, accept outcome
 - Don't substitute own view of public interest
- Since 1997 almost all rate cases settled
 - Generally multi-year incentive systems
 - Also provision of info, quality of service provisions
 - Better info and customer relationships in industry



Tolls set through traditional regulation (litigation)
 Tolls set through negotiated settlement
 Some contribution of settlement to toll determination
 Tolls not yet determined

Settlement activity since 1985

Source: NEB toll decisions

US Federal Power Commission

- 1960s US federal energy regulators faced with sudden backlog of rate cases
- Encouraged parties to settle
- They did – increasing proportion over time
- Main gain: different process led to innovative rate freezes – more certainty for both parties, better efficiency incentives
- Regulator could not legally impose these

Federal Energy Regulatory Commission (successor to FPC)

- In contrast to 'hands off' approaches, FERC takes a pro-active approach from the 1990s
 - FERC trial staff analyse utility rate request and make first settlement proposal after 3 months
 - They lead settlement discussions & counter-proposals
 - They actively seek common ground between parties
- 95% of transmission cases now settle
- Faster & more certain than conventional regulatory process

Transmission in Texas

- Texas is implementing largest and fastest transmission building programme in world
- Texas legislature authorised regulator to approve & implement transmission plan
- Regulator determined pattern of lines
- Companies bid to build; regulator selected
- Companies negotiated detailed routing with residents; controversial but 2/3 agreed
- Settlements small but important part

Public Contest method

- Argentina electricity privatisation 1992
 - Existing transmission grid: RPI-X price cap
- But *new* investment proposals had to be proposed, voted for and paid for by users
 - Then put out to tender to determine cost
 - Govt specified basis of allocating cost
- Initial problem but generally worked well
 - Users worked together to decide investments
 - Competitive tender halved cost of new lines
 - More econ investment (control equipment, not lines)

Airport non-regulation Australia

- 2000 Airports privatised, 5 yr price caps
- Then no controls, individual agreements, plus monitoring with *threat* of price control
- 2006 Productivity Commission review
 - Investment better, prices not excessive
 - More information exchanged, relationships better
 - But airline concerns: asset valuation, service quality
 - PC: need clearer threat of price control: Govt review
- 2007 Government continued policy
 - Some clarifications eg valuation of initial assets
 - Abandoned plan to clarify threat of re-regulation

Airport non-regulation Australia 2

- 2011/2 PC review: same but ACCC review
- SCL: Independent dispute resolution?
 - PC: this would lead back to regulation
 - SCL: No: evidence suggests parties prefer to settle
- PC: airports can avoid review if agree IDR
- Parties wd thus negotiate & resolve issues
- Appeal to IDR or regulator only as needed
 - This would go beyond UK and US regulation
 - Effective but minimum regulatory involvement
 - Parties actually agreed to this approach with PC
- Govt: no threat needed, just continue

Australian rail regulation

- Australian Rail Track Corporation offered undertaking to Hunter Valley coal mine cos
- ACCC role: hear views, consultation process, pronounce whether acceptable
- At late stage ARTC & mine cos did a deal:
 - higher rate of return for shorter term & more flexibility
- Both parties benefit, but ACCC dilemma:
 - whether to allow higher return than indicated?
 - ACCC: higher risk & benefits of agreement justified it
- A small step, but empowering for next time

Some developments in UK

- CAA constructive engagement mid 2000s
 - Parties invited to agree some not all parameters
 - Extension of this currently under discussion
- Ofgem 2010/11 and Ofwat 2010/11
 - Increasing role for customer engagement
 - If customers approve companies' plans then regulatory fast track rather than slow track
- Water Industry Commission for Scotland
 - Set up Customer Forum to negotiate with Co
- All regulatory initiatives: will they let go?

Still a role for regulator

- Regulator: project manage process
- Satisfy itself on who represents customers
 - Protect those not at the table
- Parties are willing & able to participate
 - If users can appeal, no need to appeal
- Enforce constraints eg government policy
- Enforce rules on information disclosure
- Provide further information if helpful
 - E.g. benchmarking, cost of capital
- Fallback appeal process if failure to agree
- In all cases, take final decision

Evolving role for regulation

- Traditional regulatory question (in UK):
- What process will enable the *regulator* to make an informed & timely decision?
- But regulator does not have to take all the decisions. Instead, new question:
- What process will enable the *parties* to make informed and timely decisions?
- Regulatory role to facilitate these processes
- Overseas experience encourages learning & innovation by Ofgem and all UK regulators