

The RIIO-2 workshop 1
Consumer voice and business plans
18 October 2017

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ofgem

| Time | Item | Leading |
|-------|-------------------------|--------------------------|
| 13:30 | Welcome and context | James Veaney |
| 14:00 | Stakeholder views | Citizens Advice and UKPN |
| 14:30 | RIO model | Rupika Madhura |
| 14:40 | Breakout sessions | |
| 15:40 | Feedback from breakouts | |
| 16:25 | Wash-up and Close | James Veaney |

Context and Background



Gas Transmission

- 1 nationalgrid
- 2 Gas Networks Ireland
- 3 mutualenergy



Gas Distribution

- 1 SGN
- 2 Northern Gas Networks
- 3 Cadent
- 4 Gas Networks Ireland
- 5 WALES & WEST utilities

gtc Independent Gas Transporters



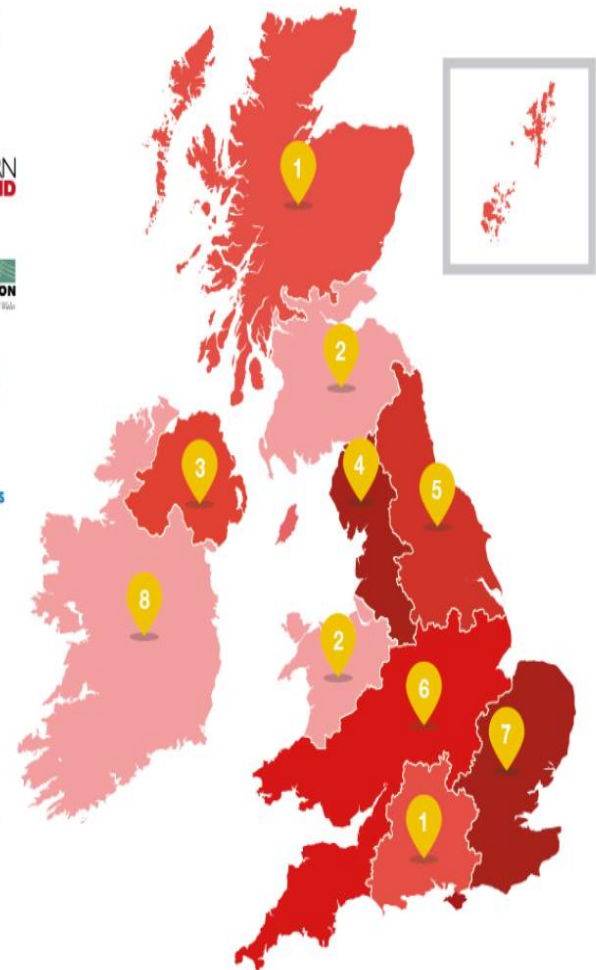
Source: Energy Networks Association, National Grid

Electricity Distribution



- | | | | |
|---|--|---|---|
| 1 | Scottish & Southern Electricity Networks | 5 | NORTHERN POWERGRID |
| 2 | SP ENERGY NETWORKS | 6 | WESTERN POWER DISTRIBUTION <i>Bringing the Midlands, South West and Wales</i> |
| 3 | Northern Ireland Electricity Networks | 7 | UK Power Networks <i>Delivering your electricity</i> |
| 4 | electricity north west <i>Bringing energy to your door</i> | 8 | ESB NETWORKS |

gta
independent distribution
network operators



- The network price controls support £bns of expenditure to ensure gas and electricity can be transported from point of generation to end user. 25% of the supply bill funds this investment
- Our approach to controlling the prices the network companies charges follows the RIIO model – where **Revenue = Incentives + Innovation + Outputs**
- The first round of RIIO price controls – gas distribution and gas/electricity transmission – end in 2021. Work on the price controls for these sectors will start next year.
- Before we launch into these reviews, we want to understand whether any elements of the RIIO framework need to change
- In July we issued an Open Letter on our approach to future price controls. In February we plan to publish a consultation on the framework for the next round of controls

- In our open letter we set out our draft overarching objective detailing what we believe RIIO-2 will need to focus on and our intention to review the RIIO framework and make changes where we have learnt lessons from RIIO-1 or where we will need to adapt to the future.
- We want to make sure that we are involving our stakeholders in this process
- Today is the first of the series of workshops, which we are holding between October and November to get your views on some of the key issues we will be considering as part of our work to review RIIO framework.

To ensure regulated network companies deliver the flexible services that consumers want and need.*

RIIO 2 will aim to achieve this by:

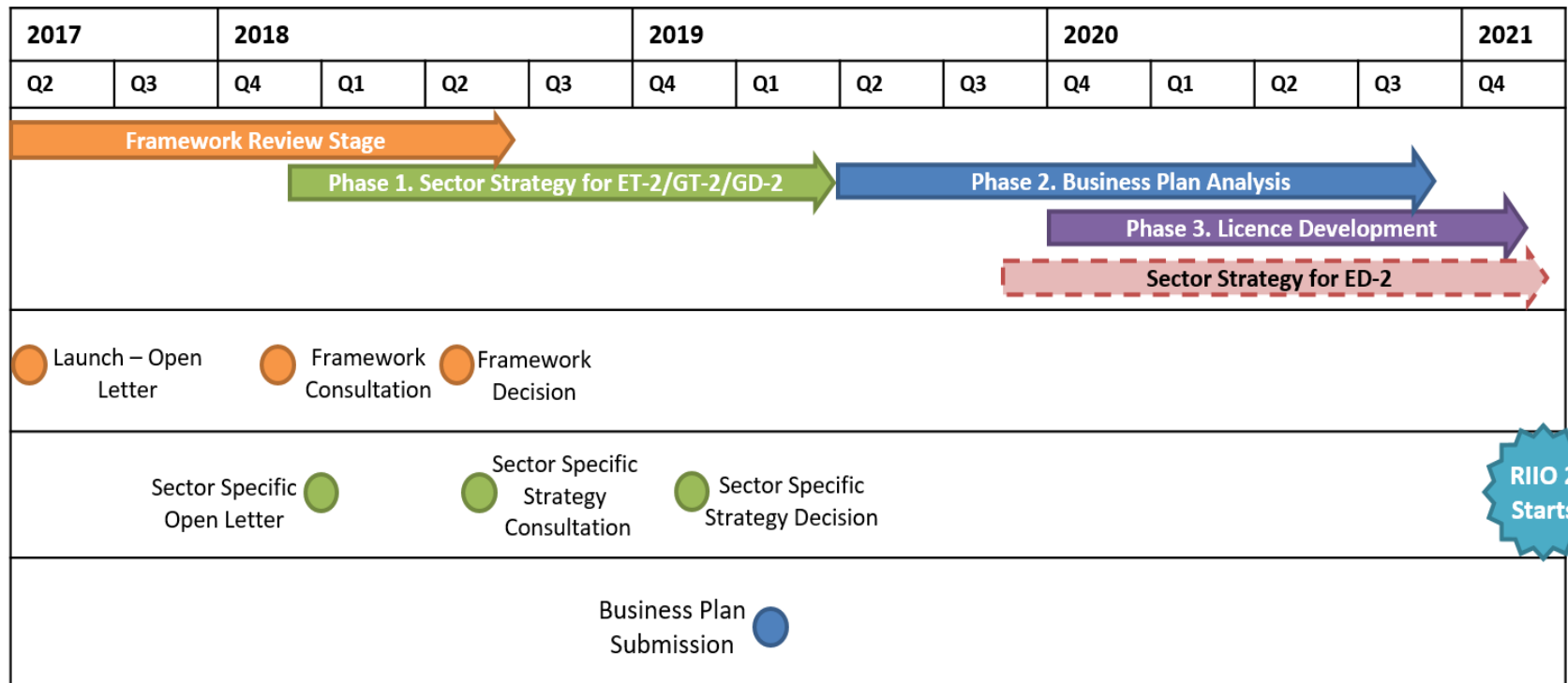
- **Giving consumers a stronger voice in setting outputs, shaping and assessing business plans;**
- Allowing regulated companies to earn returns that are fair and represent good value for consumers, properly reflecting the risks faced in these businesses, and prevailing financial market conditions;
- Incentivising companies to respond in ways that benefit consumers to the risks and opportunities created by potentially dramatic changes in how networks are used;
- Using the regulatory framework, or competition where appropriate, to drive innovation and efficiency; and
- Simplifying the price controls by focusing on items of greatest value to consumers.

- The demands placed on the energy system are changing, but there is uncertainty on the nature, rate, timing and location of these changes.
- Despite this uncertainty, Networks will need to anticipate, enable and respond to these changing demands and provide the network services required by a more diverse range of stakeholders
- From a price control perspective, stakeholder engagement fulfils two key purposes:
 - **Insight:** Companies that have insight into stakeholder needs are more able to deliver the investment and services consumers want, at a price they are willing to pay. Stakeholder insight allows companies to understand and plan for how consumers might use the energy system in the future and put in place mechanisms to react to changes.
 - **Challenge:** Stakeholder views provide a counter balance and challenge to company views and our own decisions. This helps us address issues of information asymmetry when assessing company plans and improves the quality of our decision making.
- As we approach RIIO 2, we want to ensure that we learn lessons from RIIO-1 and establish the right engagement model to drive the best outcome for consumers.



- Listen to your views on what could we do to give a stronger voice to consumers and stakeholders to achieve the necessary insight and challenge - *in particular when companies are preparing their business plans and in our assessment of them*
- Share with you our initial thoughts on the difference stakeholder engagement made to the RIIO-1 process
- Get your thoughts on alternative approaches that we could take, what benefits these could bring, what might be needed to enable these and what other options should we consider
- What we are not doing is looking at specific arrangements within a price control for stakeholder engagement

High level timetable for RIIO 2



This timetable is indicative. We will continue to develop our plans and milestones may change.

A dark blue speech bubble containing the text "citizens advice" in white lowercase letters.

citizens
advice

Presentations:

1. Citizens Advice
2. UKPN



RIIO Model

- The RIIO model promotes “enhanced engagement” for all price controls. It is not prescriptive on how and with whom that engagement should be undertaken.

Stakeholder engagement by the companies, primarily ‘insight’

- We expected networks to present ‘well justified business plans’ that had been developed through stakeholder engagement. We signalled that our decision on fast tracking would be linked to quality of consumer engagement.
- We introduced a new incentive that rewards companies for the quality of their ongoing stakeholder engagement during the course of the price control.

Ofgem-led stakeholder engagement, ‘challenge’ role

- We set up Consumer Challenge Group - 6 consumer experts to act as critical friend to Ofgem. Met with companies & with GEMA subcommittee during process.
- Price Control Review Forum enabled engagement with a wide range stakeholders on specific issues.
- We used the Consumer First panel to provide high level steer on areas of priority.

- But in addition, the overall RIIO framework, provides incentives for both ‘insight’ and ‘challenge’:
 - Customer service incentives – companies should be continuously tailoring service to meet customer needs
 - Competition amongst networks at time of price control (fast tracking, cost benchmarking) reduces benefits of information asymmetry
 - Efficiency savings – companies earn more if they can deliver outputs at less cost. Requires innovation and new ways of working with third parties.
 - To maintain reliable networks at least cost requires an anticipation of future network requirements

Breadth and diversity of company engagement increased. More accessible plans produced

Companies proposed outputs and investments and developed new services and commitments following feedback from stakeholders

PCRF provided platform for a range of stakeholders to comment and challenge company plans. Ofgem's Consumer Challenge Group provided expertise and insight into key policy areas

Consultations and engagement of third parties in working groups provided opportunity for challenge

Range of different approaches taken but difficult to assess the consistency, quality and depth of engagement

Where engagement used to justify outputs/investments hard to know if these had been properly scrutinised

How do you get the right balance in relation to competing stakeholder interests (incl. current and future consumers)

Capability/capacity of stakeholders to engage and challenge on technical aspects of plans

Not all sectors are the same

- Stakeholder engagement improved the quality and transparency of plans
- Broader range of services provided to end-consumers, particularly from distribution companies, suggesting far greater insight
- But possible that other incentives might be driving enhanced engagement and similar outcomes
- Without confidence in the consistency and quality of engagement, the role it played in setting the price control was more limited than it could have been
- The challenge placed on the company plans from stakeholders was largely unseen by us
 - Companies competing to be fast tracked (and other incentives) arguably had a greater impact in driving down costs
- **Can we enhance the RIIO-1 arrangements?**

| | |
|--------------|--|
| Ofwat | <ul style="list-style-type: none">• Each water company required to have CCG. Purpose is to review the company's engagement process, challenge phasing, scope and scale of work to deliver outcomes, advise Ofwat on effectiveness of engagement |
| CAA | <ul style="list-style-type: none">• Constructive Engagement whereby relevant sections of the airports' business plans would be agreed with the airlines before submitted to CAA.• Plans could be submitted without agreement – but hoped that it would focus regulatory review on issues of contention. |

A potentially different approach for distribution vs transmission?

Characteristics of distribution

- Closer to end consumer and range of other outputs and incentives could be driving engagement
- The number of companies allows us to benchmark costs, and incentives to reveal true costs are more powerful.
- Stakeholders are a diverse group & more likely to have limited resource – less prospect of ability to ‘agree’ the business plan
- Geographic differences might necessitate different approaches between companies, based on stakeholder input
- We need more robust assurance that variations are justified and have been properly challenged and that stakeholder engagement has been sought in a consistent and fair manner

Therefore a model based on consumer challenge panels might help provide more assurance on approach to engagement

A potentially different approach for distribution vs transmission?

Characteristics of transmission

- Less close to end consumer
- Less companies so more limited competition/incentives to drive down costs
- Stakeholders are a less diverse group & more likely to have capability of challenging plans
- Where there is agreement with large energy users, generators, suppliers, DNOs, consumer reps – there may be less need for Ofgem scrutiny

Therefore could a constructive engagement model as used in the airport sector provide more challenge to the transmission company plans





Wash-up and close



**THANK
YOU!**