

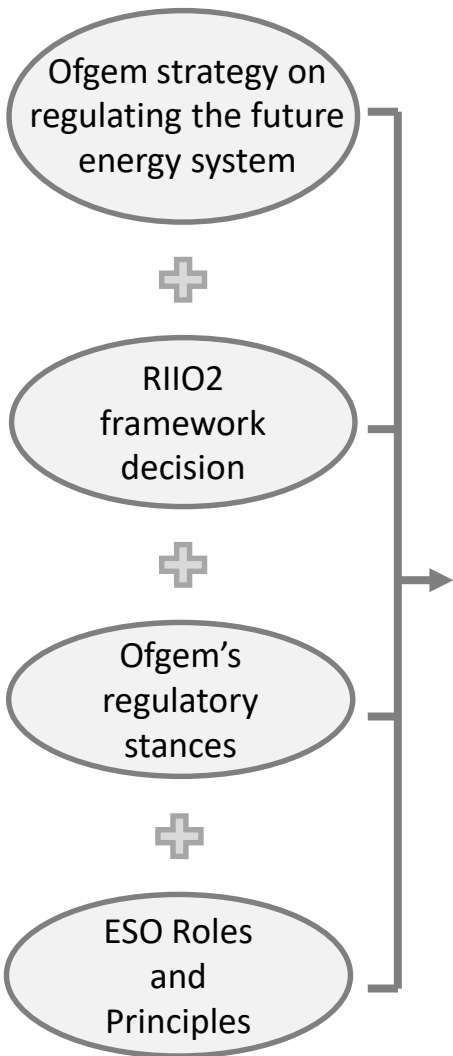
RIIO-2 Price Control for the ESO

External Stakeholder Workshop

SO Regulation team
06/08/2018

ofgem

Time	Title	Speaker
0900 – 0930	Welcome (registration, tea and coffee)	
0930 – 0945	Introduction and overview	Jonathan Brearley, Louise van Rensburg
0945 – 1015	Presentation 1 <ul style="list-style-type: none"> • Our ESO RIIO-2 Strategy • What does the ESO currently do? Is this right for 2021-26? • Four regulatory approaches we could take 	Maryam Khan, Grendon Thompson
1015 – 1100	Breakout session / workshop (including feedback time)	All
1100 – 1115	Coffee break	
1115 – 1145	Presentation 2 Key considerations for ESO RIIO2 framework design: <ul style="list-style-type: none"> • Separating price controls and incentives? • Single allowance vs. separate allowances for each service? • Remuneration of the ESO? • How to incorporate comparative assessment and the role of stakeholders? 	Barry Coughlan
1145 – 1230	Breakout session / workshop (including feedback time)	All
1230 – 1245	Closing remarks	Grendon Thompson
1245 – 1330	Networking lunch	



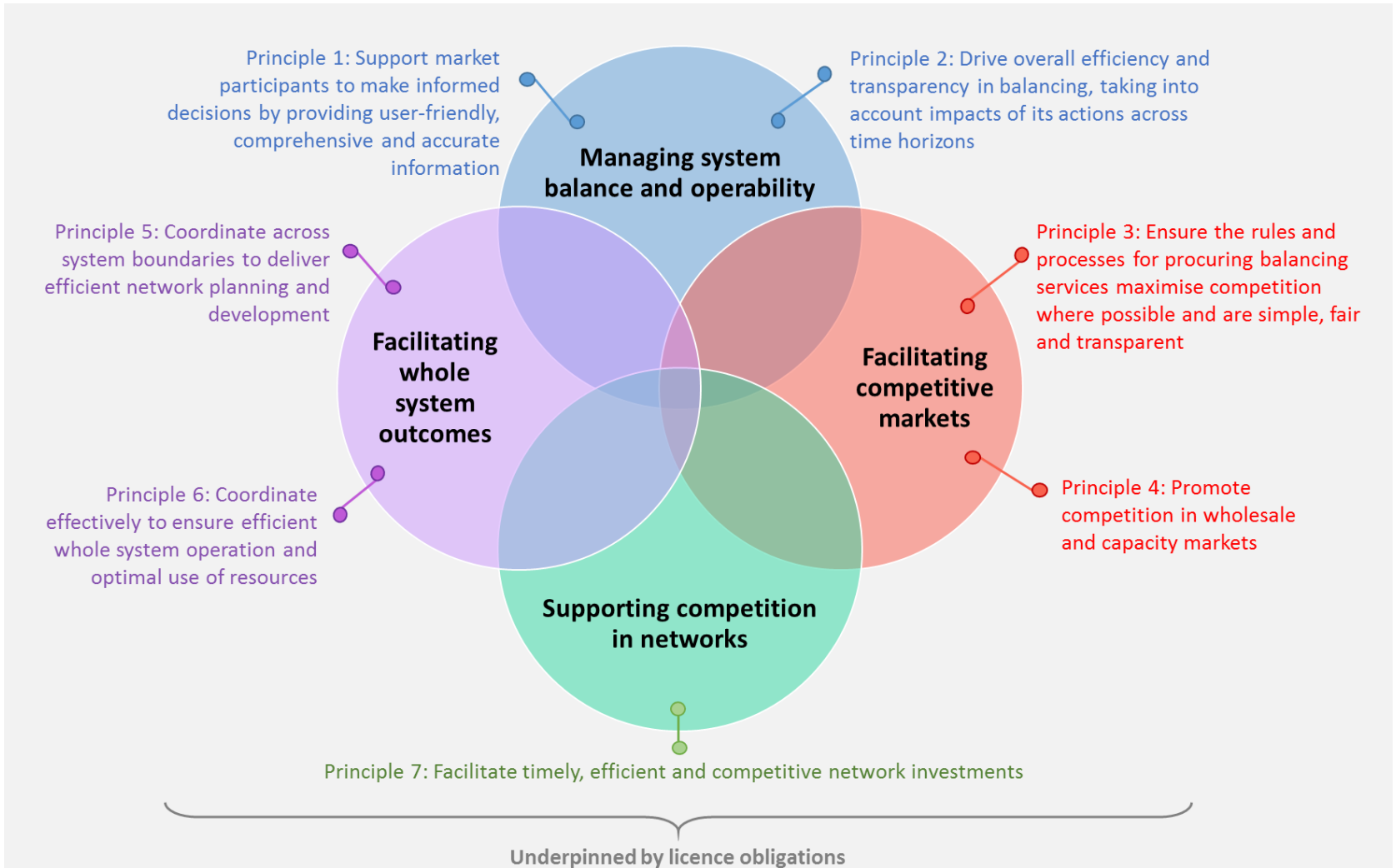
VISION

We want the ESO to play a **leading, proactive and coordinating** role in the transformation to a low carbon energy system by delivering **sustainable, resilient, and affordable services** that provide **value for existing and future consumers**. The ESO should achieve this through its **direct activities** and through its **ability to influence the whole energy system**.

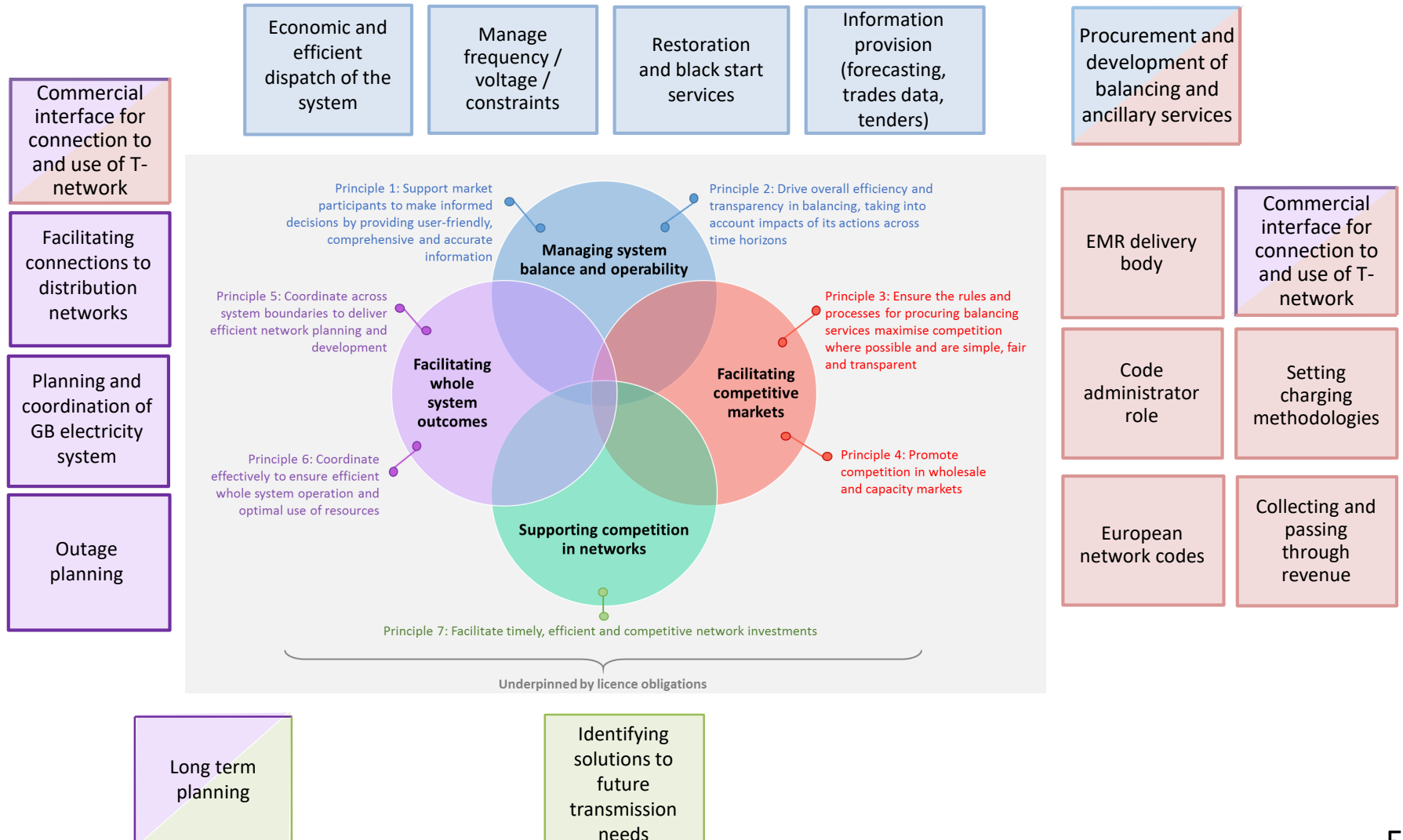
FRAMEWORK DESIGN

- The framework must ensure the ESO acts in the best interests of existing and future consumers through facilitating the ESO to demonstrate the **ESO behaviours outlined in our regulatory roles and principles**.
- A predictable regulatory regime **which supports efficient investment, allocates risks efficiently and ensures fair returns**.
- **Rewards** for delivering great service and **penalties** for not meeting expectations.
- A framework that uses **principles rather than prescriptive rules**, wherever possible, to allow for flexibility and innovation to respond to system changes.
- A more **transparent, comprehensive and holistic framework** that minimises any risks of distortion.
- A route for **stakeholders to challenge** the ESO and hold its performance to account.
- Exposure of monopoly services to **competitive or customer pressures** (where there are benefits from doing so) and charging for monopoly services that reflects incremental costs and benefits.

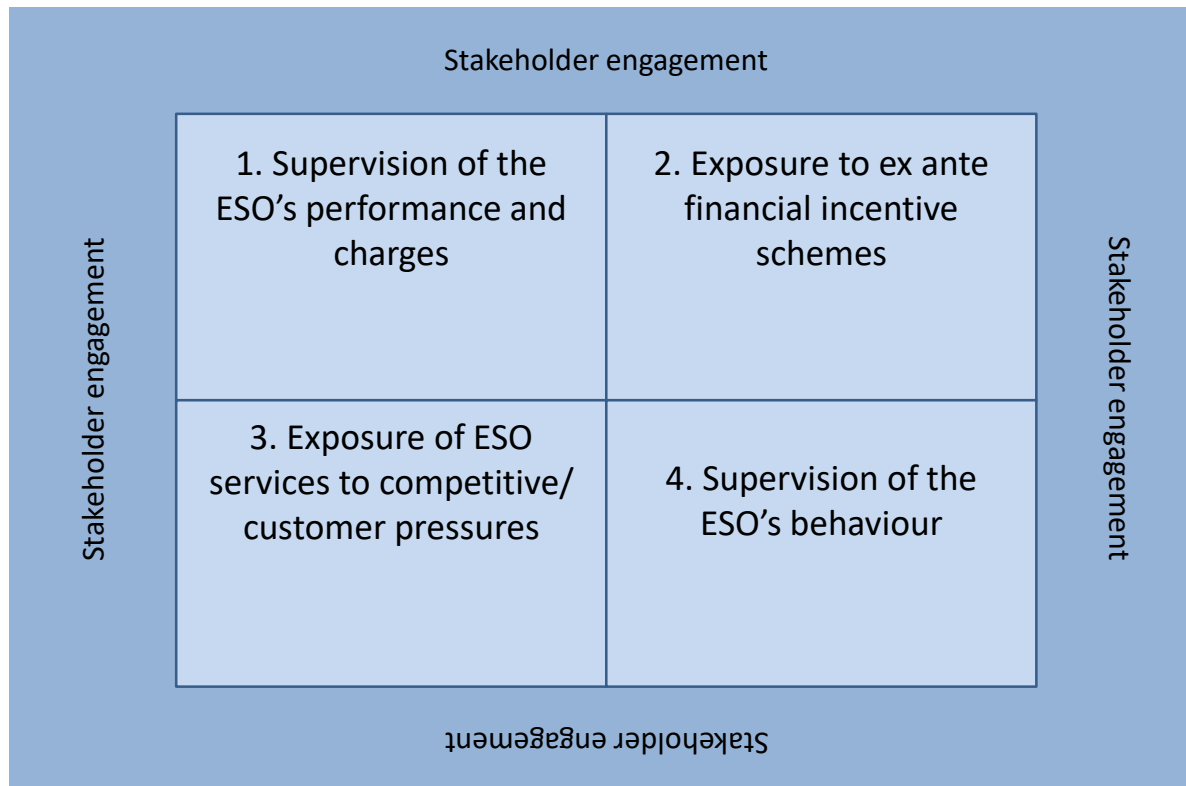
What does the ESO currently do?



What does the ESO currently do?



- How can a price control lead to good consumer outcomes?
- Different approaches may pull the price control in different directions
- Likely that a mix of all 4 are part of the overall package but not necessarily equally weighted



1. Do you think anything important is lacking from our vision and framework design points?
2. Are the ESO's 4 roles and 7 principles still accurate? Do you think anything is missing? Do you expect these to still be accurate in 2021-26?
3. Are there any additional services that you think the ESO should provide in the 2021-26 period?
4. Are there any services that the ESO currently provides that could be open to competition or undertaken by another entity?

Tea/coffee break





The ESO as a separate, licenced entity within NG Group:

- Financial trade-offs, risks and interactions

CHALLENGES



1. The ESO is a for-profit commercial company and receives funding for internal costs through the price control and has additional incentives on external costs:

- One holistic scheme (covering internal and external costs and incentives)?
- Balance between financial and reputational incentives?



2. The ESO provides a diverse set of services:

- Single allowance/ regulatory approach covering all ESO activities or separate allowances / approaches for different activities?



3. The ESO will transition into a separate, asset-light, service-focused organisation:

- Most effective methodology for remuneration of ESO costs?
- Regulatory Asset Value (RAV)?



4. The ESO has an idiosyncratic nature, delivering many services, no direct comparator:

- How do we mitigate against informational asymmetry?
- How do we incorporate comparative assessment into the regulatory framework for the ESO?

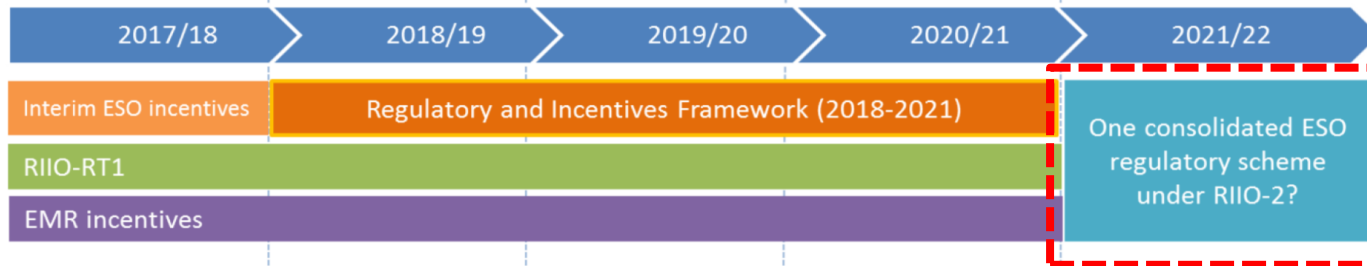


1. The ESO is a for-profit commercial company and receives funding for internal costs through the price control and has additional incentives on external costs

April 2018: Opportunity for clearer expectations, better governance and new incentives approaches better suited to ESO's evolving roles

★ ESO Legal Separation

April 2021: Opportunity to consider bringing all regulation together under one scheme



April 2019:

- Further refinements based on experience with new approach
- Ensuring new regulatory framework aligns with ESO legal separation

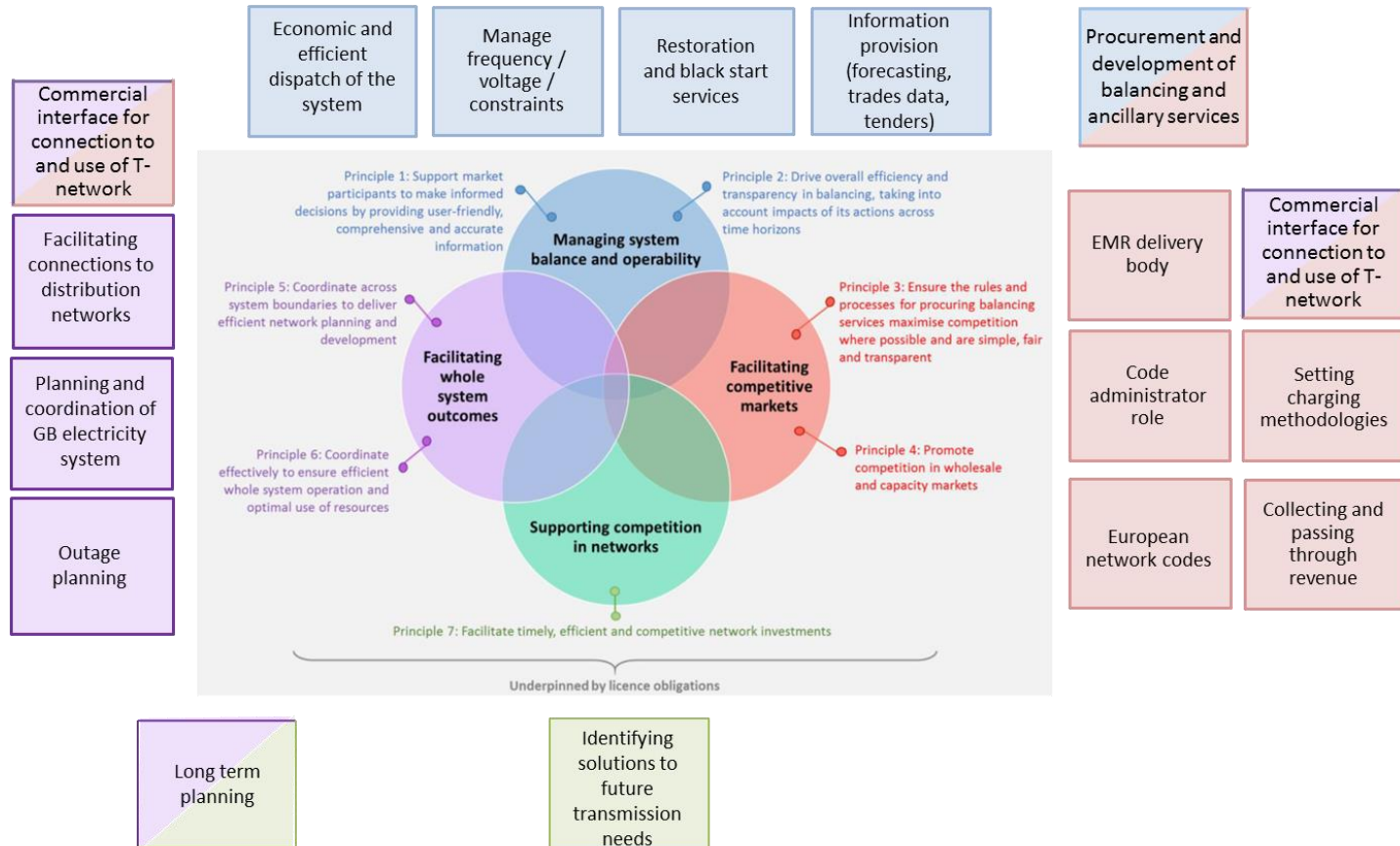
Question 1:

Should the ESO be remunerated under one holistic scheme (covering internal and external costs and incentives)

or

should we treat the price control and SO/EMR incentives as completely separate?

2. The ESO provides a diverse set of services



Question 2:

Should we have a single allowance / regulatory approach covering all ESO activities

or

separate allowances / approaches for different ESO activities?

3. The ESO will transition into a separate, asset-light, service-focused organisation:

- ESO part of NG Group = $RAV \times WACC$ (status quo)
- ESO separate and limited assets = RAV might not be appropriate?
- Most effective methodology for remuneration of ESO costs?
 - How do you ensure the ESO is financeable without a large asset base?
 - How do you determine allowances?
 - Should you place downward pressure on cost/spend of the ESO? How should you do this?




RAV × WACC
50% sharing factor
RIIO-T1
2013-2021

ESO Separation

2019

?
RIIO-T2
2021-2026




Question 3:

- i. What is the priority – cost minimisation or service provision?
- ii. Is the traditional $RAV \times WACC$ appropriate for the ESO in the future?

4. The ESO has an idiosyncratic nature, delivering many services, no direct comparator:

- How do we mitigate against informational asymmetry?
- How do we incorporate comparative assessment into the regulatory framework for the ESO?

Question 4:

- Are there any benchmarks that exist that we can use to assess the ESO's performance?
- In the absence of benchmarks, what's the best way to ensure effective scrutiny of the ESO?
- How can we best use customers and stakeholders to expose the ESO to performance/efficiency pressures?
- Should we measure performance against outputs or outcomes?



Question 1

Should the ESO be remunerated under one holistic scheme (covering internal and external costs and incentives) or should we treat the price control and SO/EMR incentives as separate?

Question 2

Should we have a single allowance / regulatory approach covering all ESO activities or separate allowances / approaches for different ESO activities?

Question 3

What is the priority – cost minimisation or service provision?

Is the traditional $RAV \times WACC$ approach still appropriate for the ESO for the future?

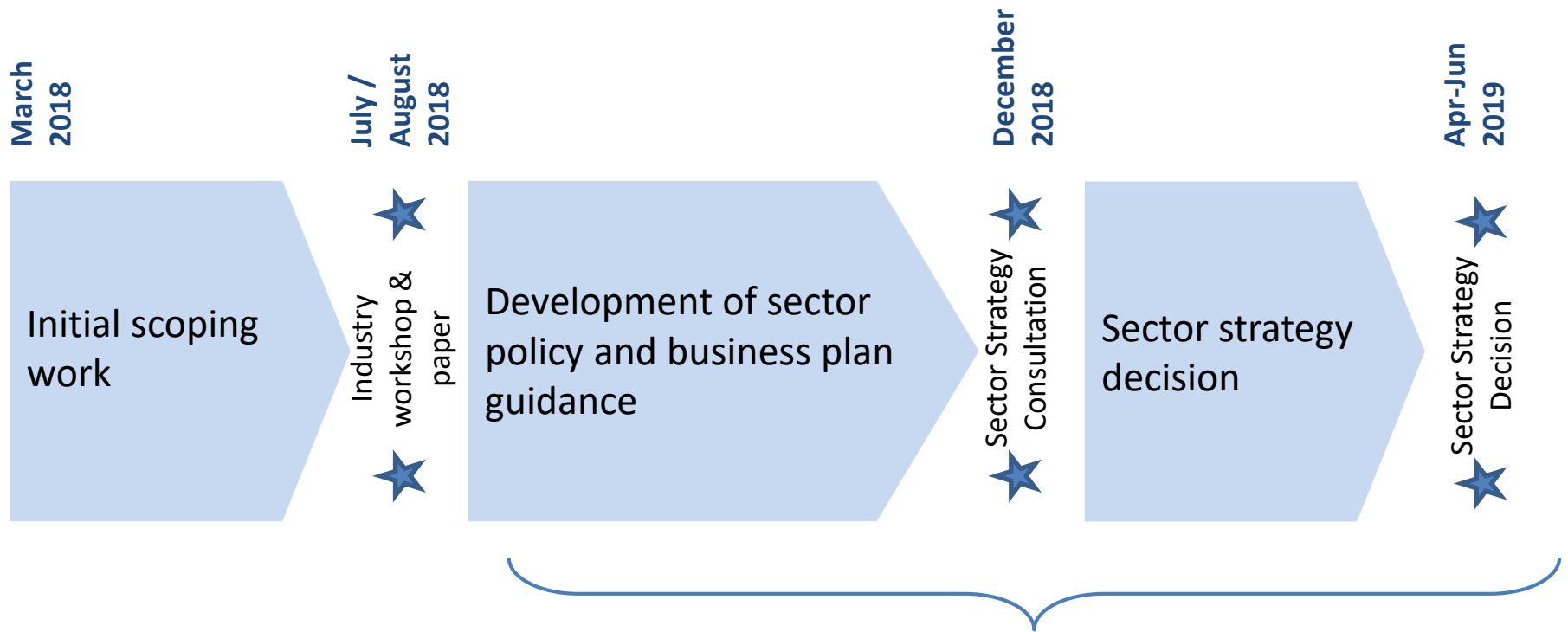
Question 4

Are there benchmarks we could use to assess the ESO's performance?

In the absence of benchmarks, what's the best way to ensure effective scrutiny of the ESO?

How can we make best use of customers and stakeholders?

Outcomes- or outputs-based approach?



Intention to be consistent with the wider
RIIO2 timelines

Wider RIIO2 working groups are planned for cross-sector issues – **is there demand for any ESO dedicated working groups?**

Thank you for your time today

Any feedback from today, please email:
electricitySOreform@ofgem.gov.uk

2018/19 ESO Performance Panel

- The new regulatory and incentives framework relies on a new independent panel of experts to assess the ESO's performance.
- We are looking for representatives from trade bodies and industry associations to be a part of the first ESO Performance Panel - further information can be found [here](#). Submissions of interest are due on 17 Aug, please email these to:
ESOperformance@ofgem.gov.uk.
- We also plan to hold an industry event in October at the mid-way stage of the 2018/19 performance period.

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