

AFRY

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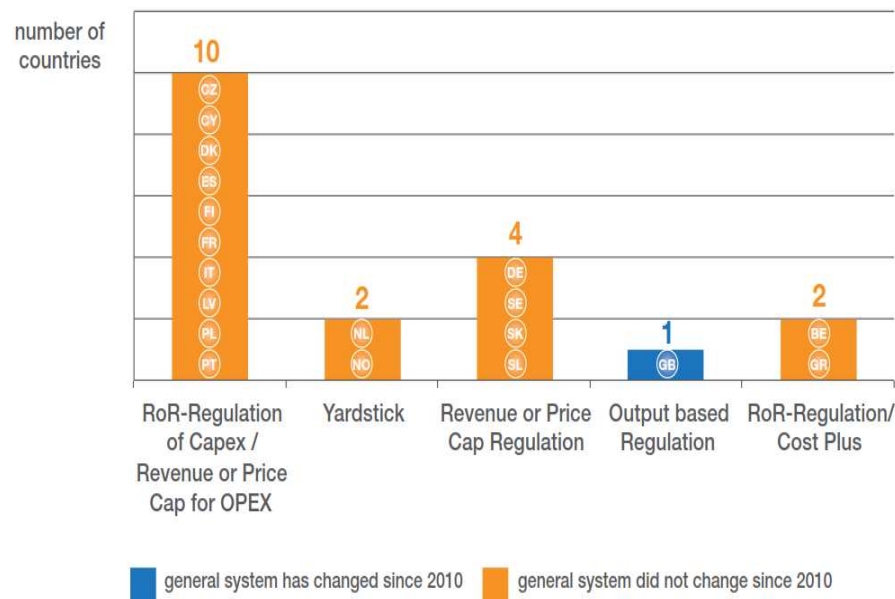
Insights from the GB Energy Sector

1ST EUROPEAN FORUM ON REGULATION OF WATER SERVICES (EFRWS)

GARETH DAVIES, DIRECTOR

Is the GB energy regulatory regime an outlier, leader or both?

COMPARISON OF EU REGULATORY SYSTEMS



- Outlier?
 - Limited examples of TOTEX-style, output-based regulation outside of GB (so far)
 - Institutional infrastructure for regulation much more mature and established
- Leader?
 - Responding to longer-term changes in the system
 - Refocussing on customer/user needs
 - Looking to incorporate solutions made possible by technology advances
- Both?
 - Useful insights even if not fully replicable

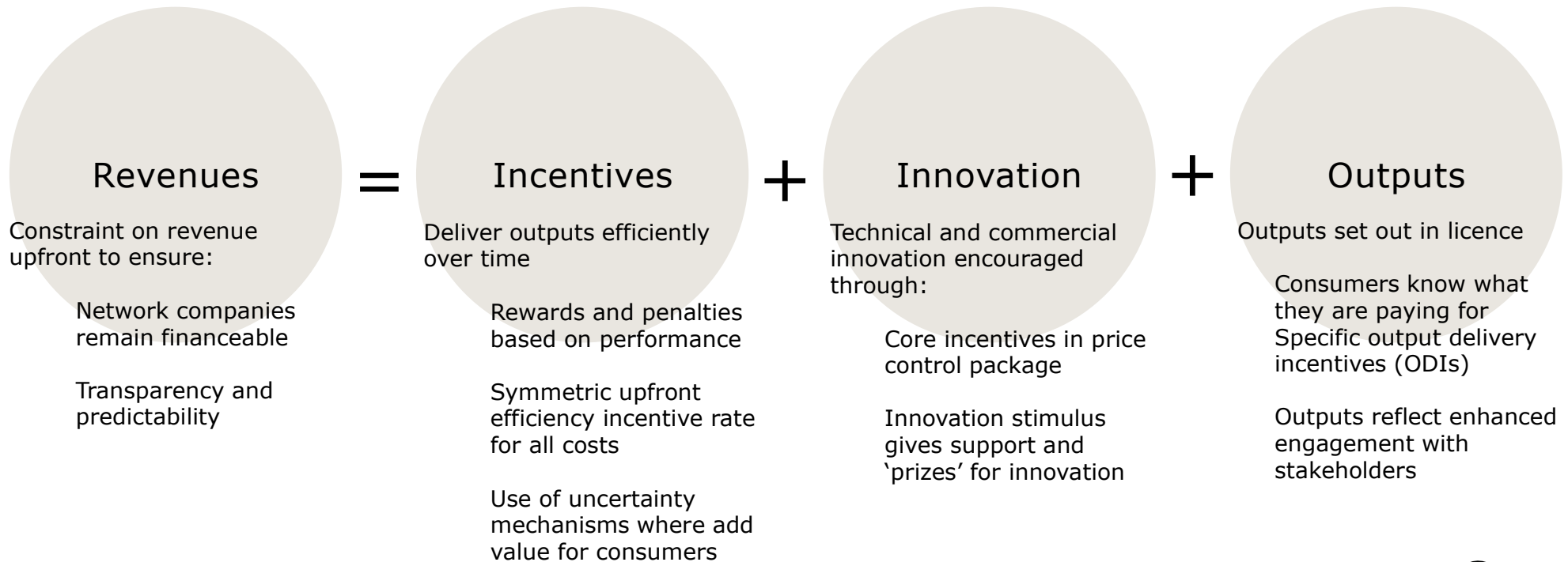
Source: Eurelectric 2016

Future challenges expose weaknesses in existing regulation

- Energy sector facing unprecedented challenges of delivering decarbonisation
- Changing patterns of production and consumption
- Emergence of new technologies and system solutions
- Over 20 years 'RPI-X' delivered significant cost efficiencies and quality improvement but focus is changing
 - Promoting innovation
 - Offering new services
 - Responding to customer needs
- Without change, there is a risk of increasing costs of provision

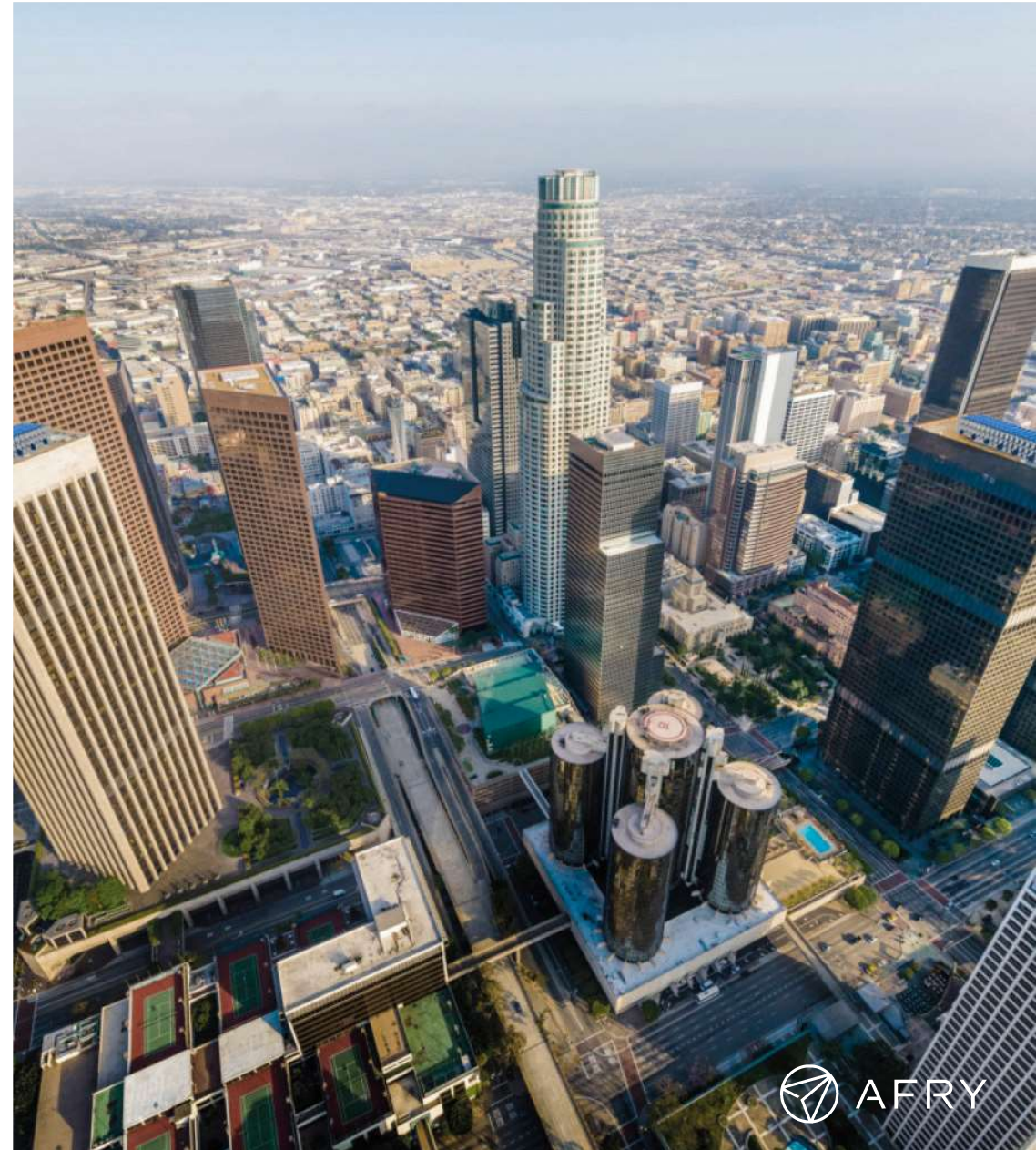


For Ofgem the answer was RIIO...



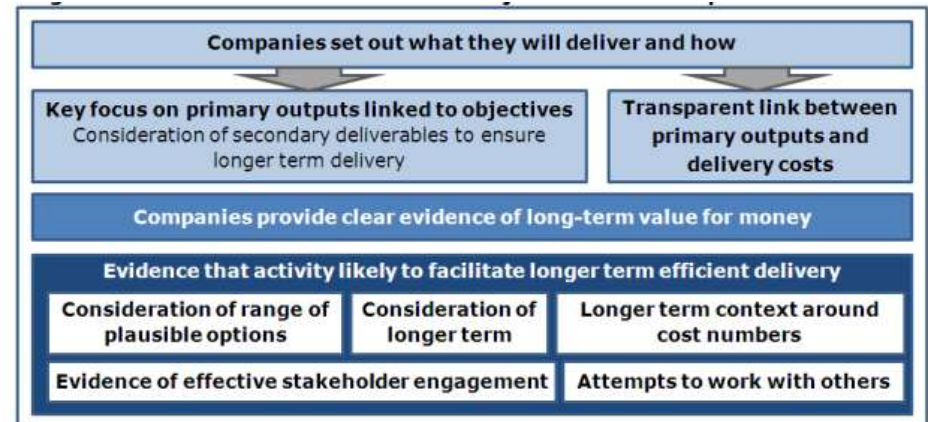
Several interesting initiatives

- Importance of detailed and challenging business plans
- Focus on outputs/outcomes
- TOTEX-based approach
- Emphasis on innovation



'Well-justified' business plans

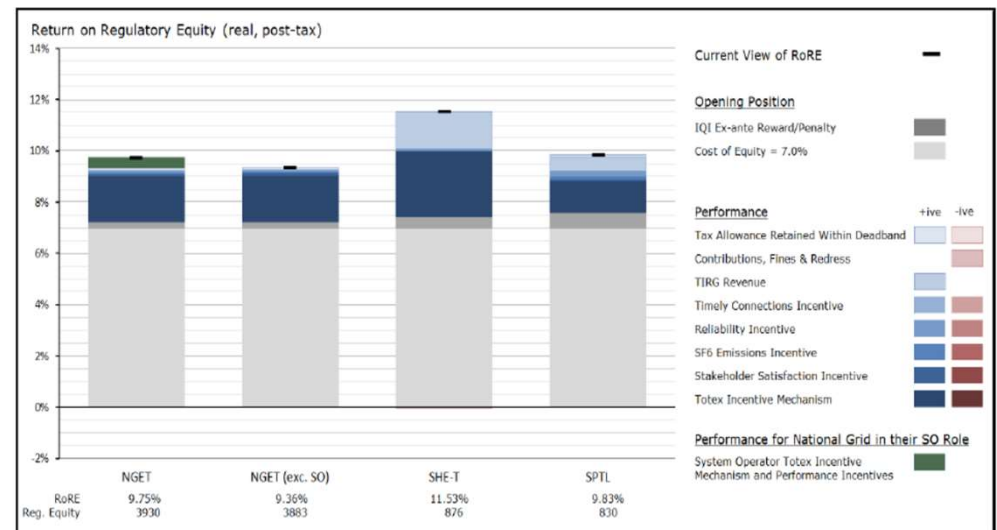
- The business plan is a core deliverable under the RIIO framework
- Presentation of the projections of activities, costs and outputs of the business
- Incentives for companies that meet regulator's expectations of a well justified plan
 - Additional base revenue allowance
 - Higher efficiency incentive rate
 - 'fast-tracking' of process



Outputs and outcomes drive plans

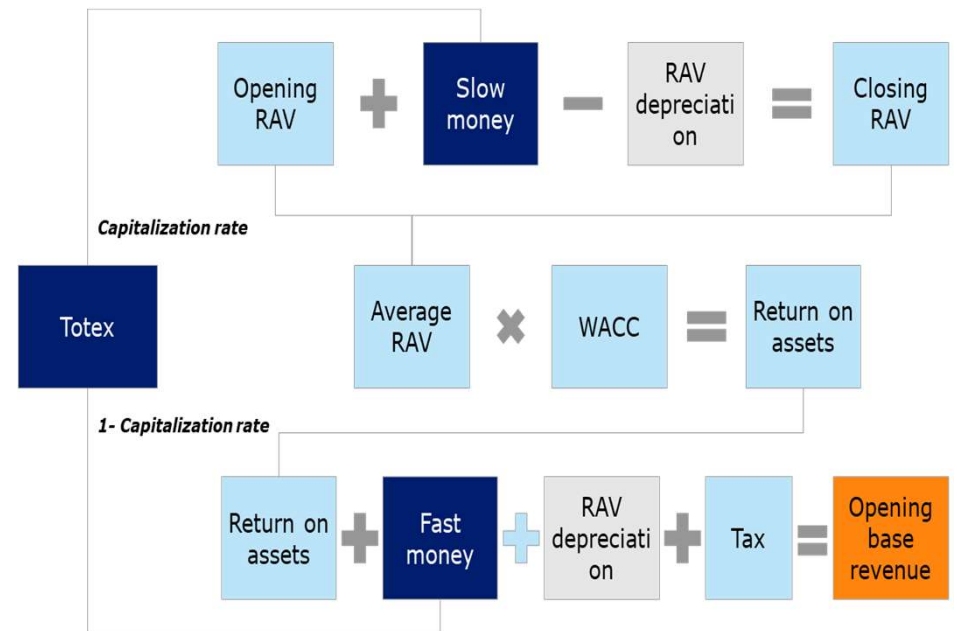
- Regulated companies must meet the needs of consumers and network users in three areas
 - High quality, reliable service
 - Safe and resilient network
 - Environmentally sustainable network
- Three types of outputs identified
 - Licence obligations
 - Price-control deliverables (specific deliverables with identified funding)
 - Service level improvements (Output Delivery Incentives (ODIs) with financial rewards/penalties)
- Uncertainty mechanisms linked to outcomes
- Strong role for stakeholder engagement in setting targets and challenging plans

- Scope for outperformance benefitting company and users



TOTEX-Based regime

- TOTEX benchmarking
 - Combination of comparative cost assessment at an activity/cost category and TOTEX level
- TOTEX-based incentives
 - Symmetric treatment of under- and over-spending regardless of nature of expenditure
- Decoupling of RAV additions from CAPEX
 - Introduction of the concept of 'slow' and 'fast' money to ensure indifference between OPEX and CAPEX solutions



Innovation is critical for long-term sustainability

- No additional return for strategic or innovative investments
- Several levers for promoting innovation
 - Cost assessment – TOTEX-basis, holistic options assessment process
 - Output incentives can support new business models
 - Time-limited innovation stimulus packages such as Network Innovation Allowance (0.5% - 1% of base revenue), Network Innovation Competition



FOCUS ON WHAT USERS NEED

- Regulate for sustainable outcomes – what users need and are willing to pay



EMBRACE INNOVATION

- Digitalisation and new technologies create opportunities to deliver outcomes at lower cost



FUTURE-PROOF PLANS

- Demographic and climate change will affect demands on the system and need to be reflected in plans



ENSURE FAIR REWARDS

- Regulated companies need to be rewarded for good performance

An aerial night view of a city, likely Shanghai, with numerous skyscrapers and light trails from traffic. A network of glowing yellow lines and nodes is overlaid on the city, suggesting a digital or infrastructure network. The text "Making Future" is centered in the image.

Making Future