

Future of Energy Regulation?

Dermot Nolan

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Genesis

- Regulation associated with the liberalisation of energy markets and the privatisations of the 1980s
- Bring benefits of competition to formerly monopolistic sectors
- Retail and generation seen as competitive, while natural monopolies subject to incentive-based price regulation
- Implicit (or explicit?) expectation that, over time, regulation around the competitive elements would “wither away” and that energy would be treated the same as any other product

Why independent regulation?

- Ofgem one of a number of independent economic regulators
- Primary statutory aim to protect consumers from market power abuse by (privatised) companies
- Independence also designed to protect investors from ex post appropriation of their assets by Government
- Regulators designed to be a reservoir of technical and economic expertise that would not exist in most Government departments
- Model of independent regulation gradually taken on by EU and extended across member states

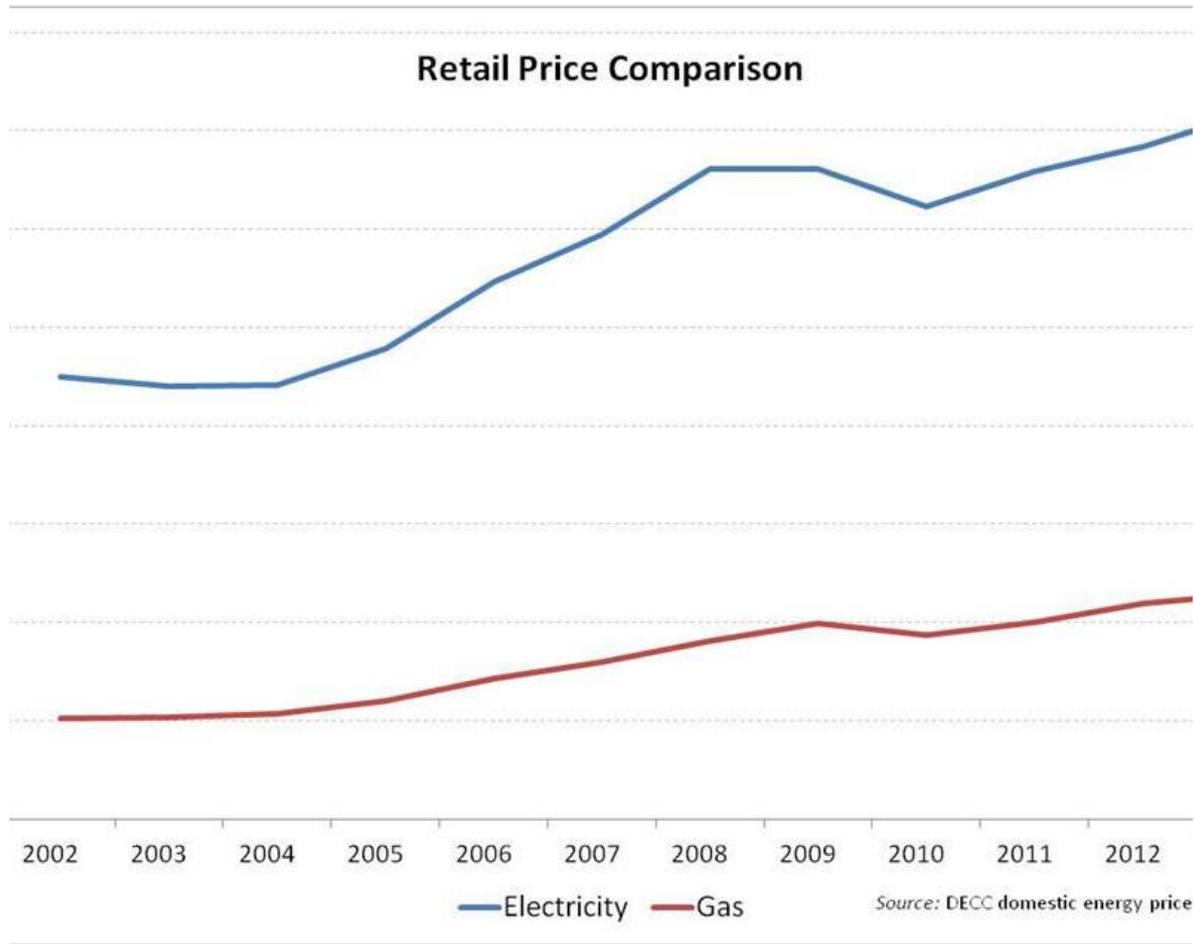
Outcomes

- By, say, 2005 the outcomes delivered by regulatory and market framework seen as highly successful
- Retail markets all fully de-regulated
- Generation market moved from Pool market to NETTA/BETTA arrangements
- Wholesale gas markets de-regulated
- Network unbundling plus clear evidence of sustained falls in network costs

Troubles

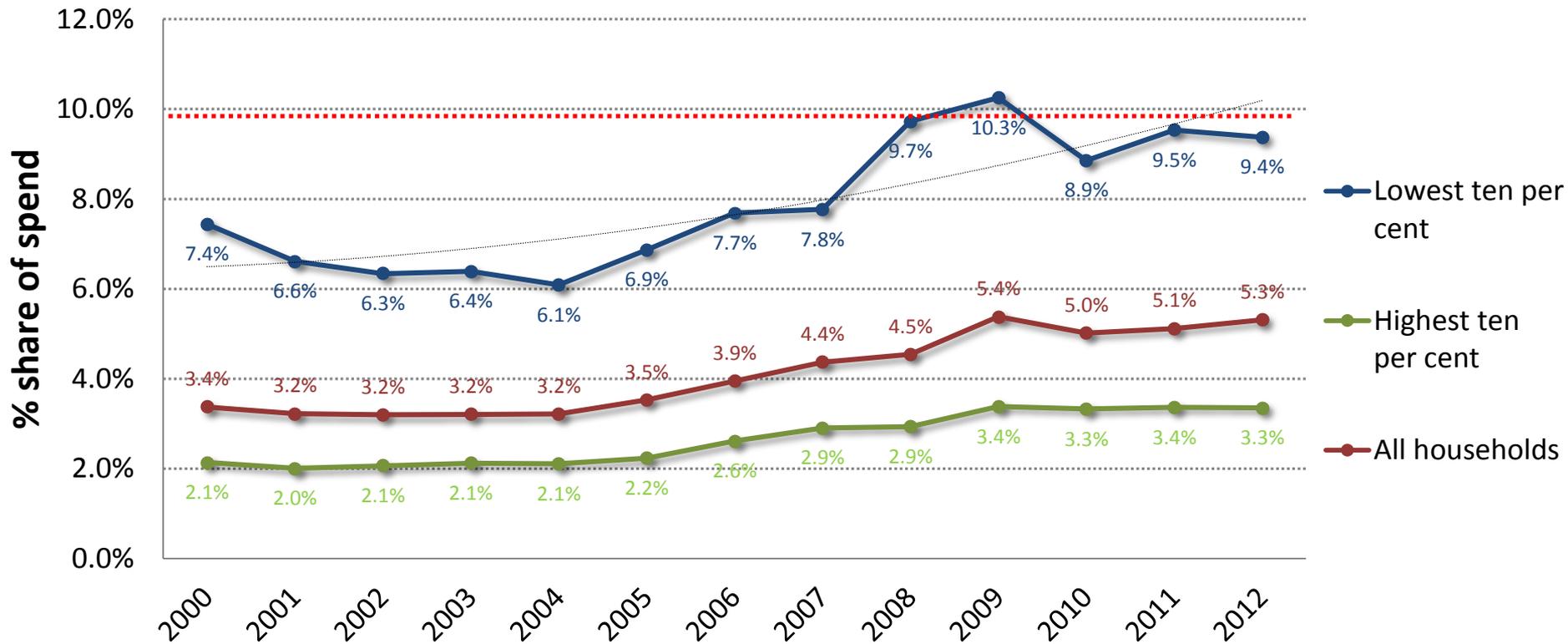
- Energy prices have risen considerably since 2005, predominantly driven by fossil fuel increases
- De-carbonisation of the sector also driving up prices
- Consumer dis-satisfaction has risen – perception of poor customer service and diminishing trust in suppliers
- Increase in Government and media scrutiny of the sector and the regulatory arrangements
- Investor confidence seems to have fallen at a time when significant new investments are needed

Retail Price Comparison

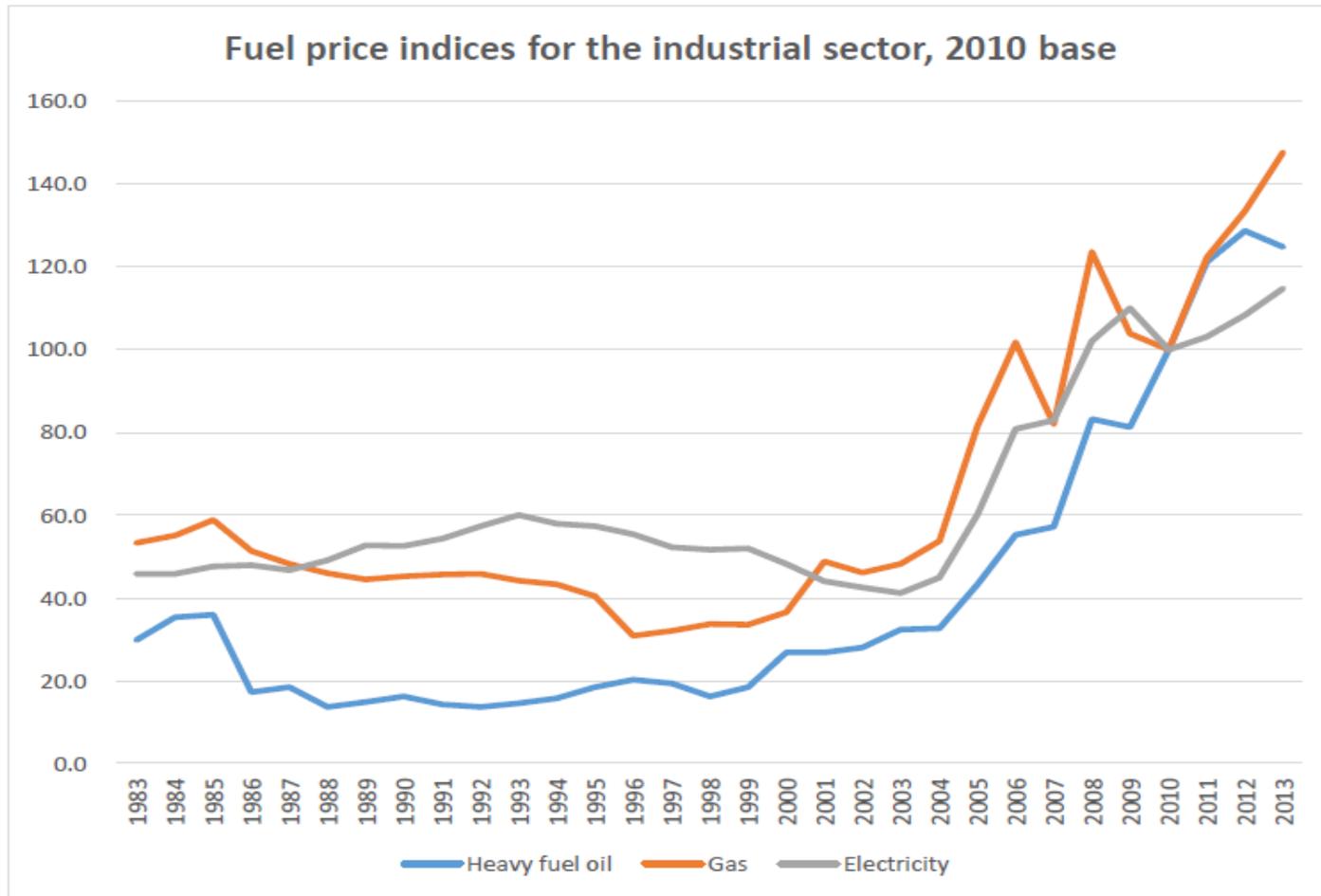


Average Weekly Household Energy Expenditure by income deciles 2000-2012

Average Share of Gas and Electricity in Weekly Household Spend (Excluding Housing Costs) by Income Deciles, %



Source: ONS "Family Spending", various releases (1993-2013); own calculations. The survey covers around 5,000 households across the UK. Data are for gross income deciles. Weekly expenditures exclude housing costs (rent, mortgage interest and council tax).



Expectations

- Unsurprising that price rises have brought increased scrutiny and intervention – similar patterns in other EU countries
- Regulatory framework subject to considerable criticism – seen by some as permitting prices to rise unreasonably and service quality to fall
- Concerns that complexity of tariff structures and associated firm behaviour have put industry in “unhappy equilibrium”
- Questioning of the idea that energy is like any other product or service, with calls for various different forms of intervention that are specific to energy markets
- Some questioning of whole role of competition in energy markets, and, more recently, questioning of performance in regulation of monopoly networks

Blame?

- Energy firms? Ofgem (and OFT/CMA) analysis suggests rise in profits predominantly linked to increased tacit co-ordination
- Regulator itself? Ofgem put in place a variety of measures since 2005 which some commentators have argued have restricted competition and raised prices
- Policy makers? Lack of clarity re cost of de-carbonisation, allied to increased uncertainty and fear of ex post interventions raising cost of capital

Responses

- Government has put in place the Electricity Market Reform (EMR) legislation
- Variety of elements: (i) Capacity mechanism/auction to stimulate new (mostly gas) thermal entry; (ii) CfDs for renewable generation to stimulate new renewable entry
- This is policy intervention in an area that might have been seen as being within the regulatory bailwick
- Some question degree of compatibility with traditional framework of competition – Government becoming single-buyer?
- It has *complicated* the regulatory architecture – various new bodies being set-up with different responsibilities

Market Reference

- Ofgem engaged in a number of studies and interventions into retail competition
- Ultimately, energy markets referred to the CMA in 2014, with report due by end-2015
- CMA has published initial views on scope, including retail competition, structure of generation market, and vertical links between them
- Not examining areas such as wholesale gas markets, or network regulation

Regulator's perspective

- Would like full and independent examination of these issues
- Regulatory role and performance part of this
- Regulation stance questioned for being either too interventionist or not interventionist enough
- Overall, hope that the outcome focuses on providing certainty looking forward
- However, conscious that market reference is not a panacea and that issues/problems will still be there afterwards

Future trends

- Fossil fuel prices forecasted to rise in future, though considerable variance in such forecasts
- Environmental costs also forecasted to rise as more renewables come onto the system
- Technological innovations in the offing through Smart meter roll-out and associated Smart Grid improvements
- Should facilitate competition and empower consumers
- Increasing role of EU – move to an EU-wide energy market with greater interconnection and flows between member states

Future debates

- If energy prices continue to rise, questions about competitive and regulatory delivery , as well as about degree of de-carbonisation, unlikely to go away
- Regulator needs to make case for benefits of competition as well as clarifying for policy makers and the public what it can and cannot do
- Ultimately, regulatory powers and actions are (quite properly) circumscribed by societal views and expectations
- But hopefully scope to facilitate innovation, new and potentially more efficient business models, and the driving down of costs to consumers

Future regulatory actions

- In markets, regulator believes in competitive model: improving transparency and consumer information; reducing switching times and costs; facilitating collective switching; fostering innovative entry; improving quality of service partly through setting standards of conduct for suppliers
- In networks, drive RIIO price control process, but also focus on bringing greater competition where possible.
- Offshore transmission has seen beginning of competitive tendering – may be scope to increase competitive delivery in onshore networks

Future architecture

- Institutional and decision-making frameworks matter
- Policy and regulatory framework has become much more complex over the last 10 years, with a proliferation of bodies tasked with quasi-regulatory functions
- Such architecture could change significantly over the next few years
- Regulator will need to work in partnership with other entities while still retaining key tenets of independence

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We work effectively with, but independently of, government, the energy industry and other stakeholders. We do so within a legal framework determined by the UK government and the European Union.