Just how immune are GB energy networks from policy uncertainty?

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Context: relative policy vulnerability of energy markets and energy networks

- Energy (as with utility areas generally) is normally a highly political area
  - its contemporary political salience being reflected in whether or not there is a Department of Energy at the time – which, in turn, has tended to reflect what has been happening to global energy prices
- Electricity and gas market's high political profile and exposure to policy changes
  - impact on policy of the rises in retail energy prices
    - political pressure on Ofgem to 'do something', leading to restrictions on price discrimination, limiting of number of tariffs and the CMA market investigation
    - threats of price freezes and, more recently (CMA), price controls
  - EMR's continuation of the substitution of subsidy and administrative decision-making (CFDs and the Capacity Mechanism) for the wholesale market
    - followed by (still ongoing) twists and turns in subsidisation of low-carbon energy
- Compared to this, energy networks have appeared somewhat insulated from political/policy changes

Energy networks do face risk/uncertainty

- 8 year (more or less fixed revenue) price controls, albeit with 'uncertainty mechanisms'
- At least for some (big) enhancement projects, increased regulatory focus on network contestability, partly driven by WACC numbers from
  - offshore transmission
  - Thames Tideway

  with obvious potential implications for future rates of return on core networks
- Underlying uncertainty about consequences of asset stranding, especially for ‘declining’ networks, driven by some mixture of
  - technological change (e.g. behind-the meter-generation)
  - resource depletion (gas transmission)
  - declining demand which could have a policy dimension
  - new entry at different stages of the value chain
- Some people still remember the Windfall Tax

But

- Whatever the impact of policy change on some network issues, e.g.
  - Access
  - Charging
- Network revenue/profitability has been relatively insulated
  - Regulators (Offer, Ofgas, Ofgem) have been more or less left to get on with setting network price controls
  - By and large, regulators have avoided arbitrary (or politically sensitised) changes in setting price controls
    - May have been efforts to keep headline price changes within a range of political acceptability but WACC changes (and, therefore, returns to investors) have typically been based on market evidence (and have lagged capital market trends)
- How sustainable is this (relative) freedom from political interference?
  - To some extent (but not entirely), reducible to a question about the sustainability of independent regulation

‘Independent’ energy regulation Version 1 (1990sish)

- Energy policy largely subsumed in promotion of competition (give or take the odd gesture to nuclear or coal) and thus, effect, contracted out to regulators
- Offer and Ofgas charged, in effect, with
  - promoting competition where possible
  - preventing monopolies (initially covering supply as well as networks) from exploiting their monopoly power
- Windfall tax apart, policy exposure meant regulatory exposure
- For networks, regulatory risk mainly a matter of reducing (quite substantial) economic rent
  - 1995 re-opening of electricity distribution price controls
  - British Gas’s (largely self-inflicted) battles with Ofgas

Version 2 (from then until now)

- Driven by mixture of
  - change of government in 1997
  - Utilities Act 2000
    - rebalancing of regulator’s obligations
  - Energy White Paper of 2003
    - formal recognition of decarbonisation alongside security of supply and affordability – creating conflict especially between decarbonisation objective and Ofgem’s primary duty to consumers, assumed by Ofgem to be significantly about price
  - EMR
- Resulting in
  - Modification of Ofgem’s statutory obligations in successive Energy Acts
  - Shrinkage of Ofgem’s scope
    - DECC taking increased responsibility for wholesale markets and network access
  - Strategy and Policy Statements which, within the framework set by the Energy Act, set out what DECC wants Ofgem to achieve
    - Aim is that Statements will not usually be more frequent than one per Parliament and will leave Ofgem ‘independent’ in a day-to-day sense
- Bottom line is that Ofgem still left to get on with network price controls without substantial political interference

What Ofgem does and does not do

Core Ofgem	Grey area	DECC
‘Routine’ network regulation – e.g. price reviews	Significant changes to network regulation, especially when important to delivery of policy outcomes (e.g. transmission access and pricing)	‘Big’ changes to structure of energy markets, e.g. EMR
‘Delivery’ of specified programmes - Eserve	Tweaking of operation of wholesale and retail markets	Overall responsibility for energy market outcomes
Monitoring of wholesale and retail markets		

Version 3?

- From a network point of view, current position underpinned by survival of Tory - (Old) New Labour consensus on the appropriate division between market and state activities
  - and acceptance of the importance of adequate and stable rates of return to underpin private sector investment in infrastructure
- In addition, periodic price review give a safety valve, not there with longer term contracts (PFI, CFDs?), for very high rates of return
  - thus reducing risk of a government rent grab
- If, however, political centre of gravity substantially shifted, then (and select whatever cliché one wants) this would be a potential game changer