



World Forum on Energy Regulation IV

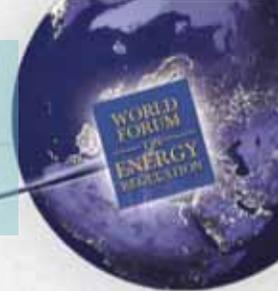
Athens, Greece

October 18 - 21, 2009

**“BEST PRACTICE: REVIEWING THE GB’S
PRICE CONTROLS AFTER 20 YEARS!”**

ALISTAIR BUCHANAN CBE - CHIEF EXECUTIVE, OFGEM

SETTING THE SCENE FOR OUR 20 YEAR REVIEW

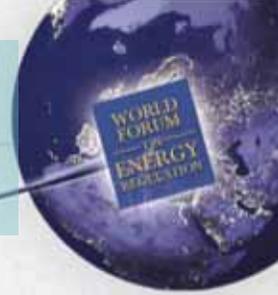


- Tapping into a lot of interest in the future direction of network regulation.
- Timing works well for Ofgem in managing the regulatory cycles.
- Financing issues pushed to the fore by recent events in capital markets.
- In tune with 'Forward looking' Ofgem...transmission access reform, offshore regulatory regime, sorting out charging methodologies.

CALLED RPI-X@20

RPI@20 CATCHES THE “MOOD FOR CHANGE”

RPI-X: A VERY SUCCESSFUL PRODUCT



A 20 year “score card” would read:

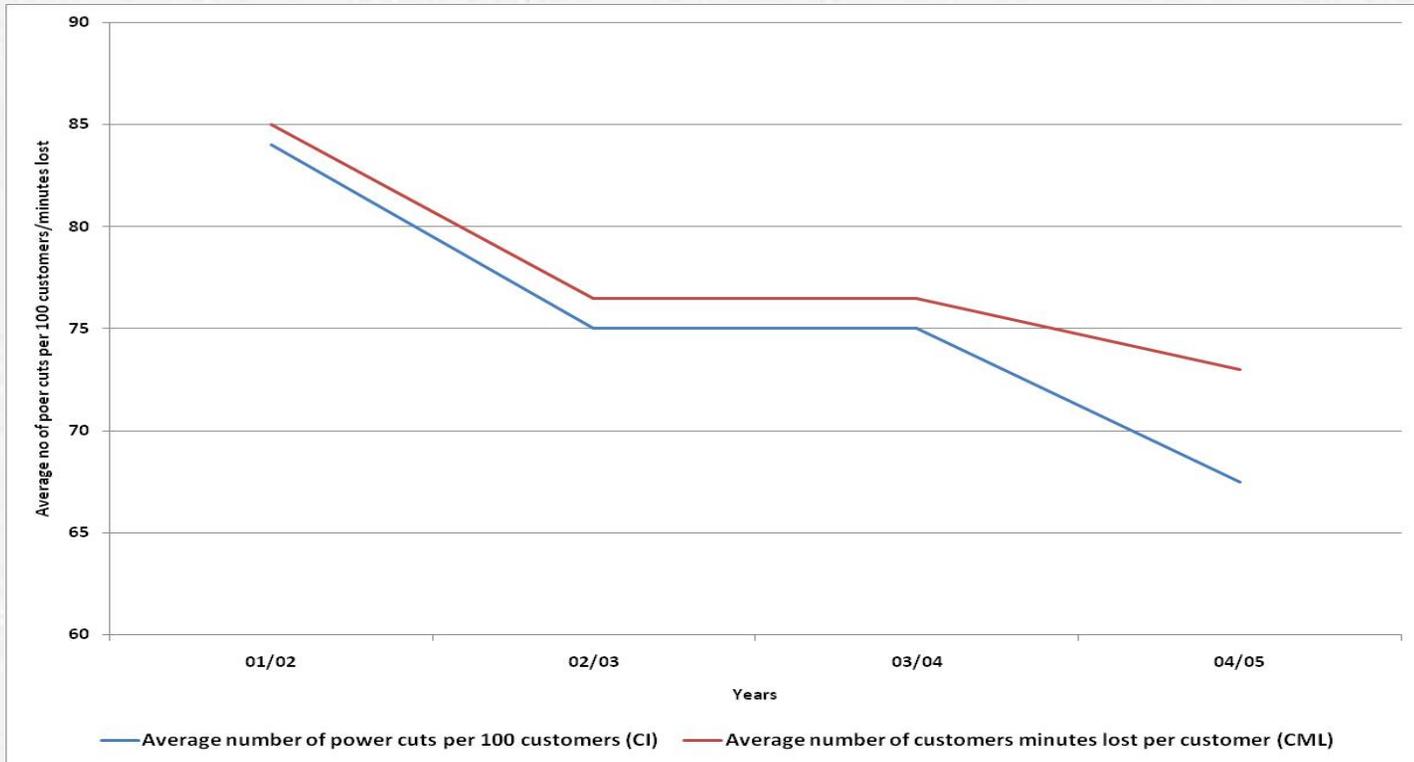
- Major savings for consumers
- Quality – up.
- Investment – up.
- Innovation – encouraged.

A SAFER, MORE EFFICIENT, HIGHER INVESTED INDUSTRY

QUALITY UP



Number and duration of power cuts (2001/2 to 2004/5) – excluding exceptional events.



1990-2005 POWERUTS -11% DURATION – 30%

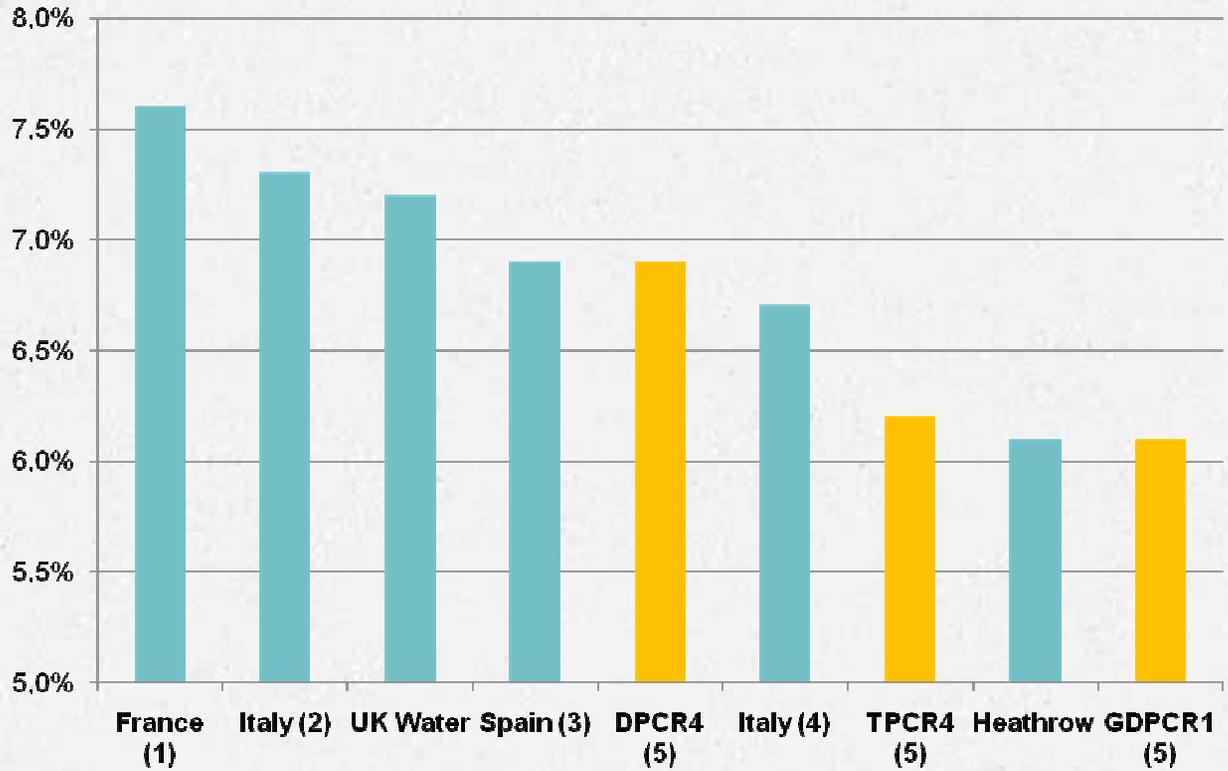
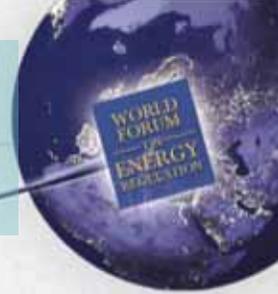
INVESTMENT UP



- Investment under CEGB.
 - Transmission networks 1984 – 1989 = £0.25bn/year.
 - Distribution networks 1986-1990 = £0.75bn/year.
- Investment under Privatisation and RPI-X:
 - Electricity transmission networks £6bn 1991-2005. (£0.4bn/year).
 - Electricity distribution networks £15.5bn 1991-2005 (£1bn/year).

UNDER RPI-X INVESTMENT HAS BEEN HIGHER THAN IN THE PERIOD BEFORE PRIVATISATION

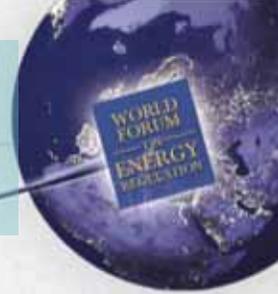
SECURING A LOW COST OF CAPITAL



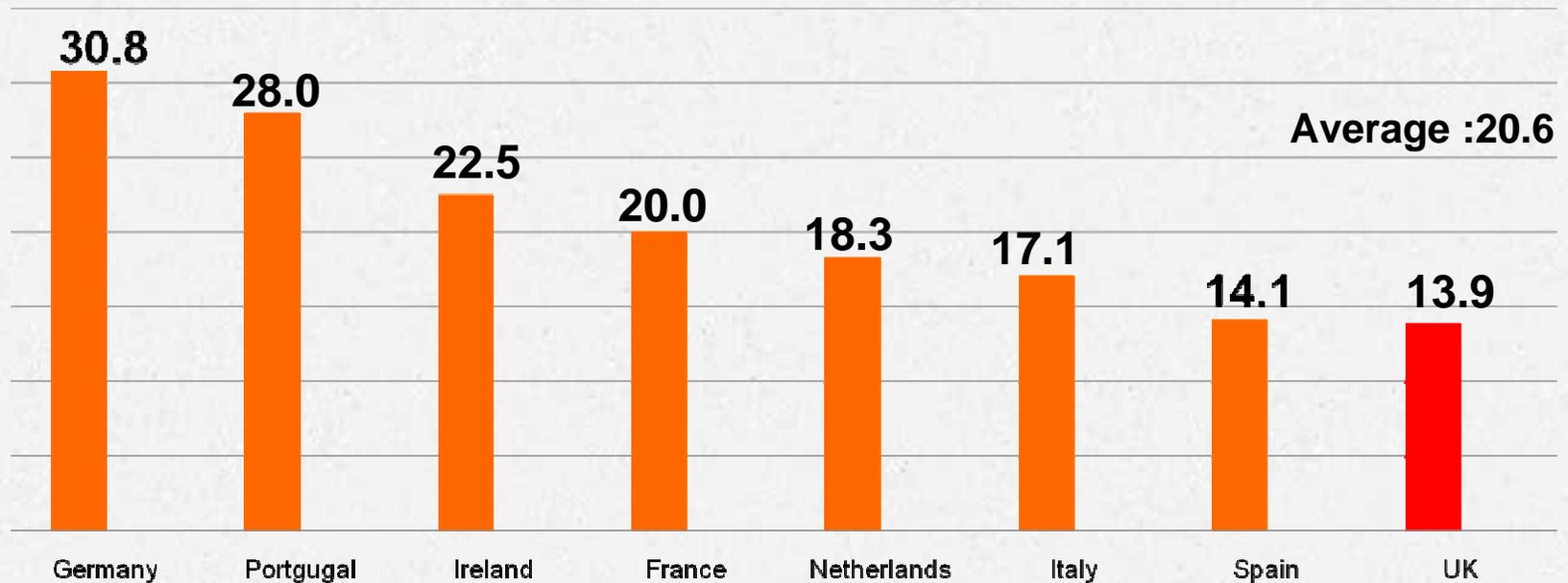
- Source: Goldman Sachs/SSE
- Key;
- 1. Transmission from Jan 05
- 2. Distribution 04-07.
- 3. Distribution current.
- 4. Transmission from Feb 04.
- 5. Post tax vanilla WACC.
- TPCR4 5.05%
- Heathrow 5.06%
- GDPCR1 4.94%

HUGE BENEFIT TO CONSUMERS FROM LOW WACC

ENSURING EARNINGS ARE REASONABLE



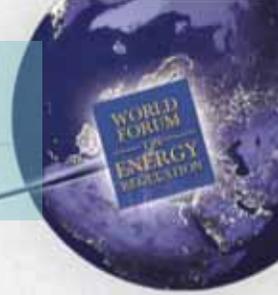
Earnings per energy unit (Eur/MWh)



Source data: Asociacion Espanola de la Industria Electrica (UNESA) Spain.

Source presentation: Iberdrola, Strategic plan regulated business – October 4 2006 Madrid.

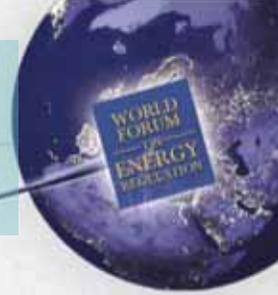
SO WHY REVIEW A WINNING FORMULA?



- Good housekeeping.
- Fits in the regulatory cycles.
- Evidence available on DPCR4 initiatives.
- Align with European Regulators Agenda.
- Paradigm shifts? Renewables, better regulation, financials.

RIGHT TIMING IS CRITICAL

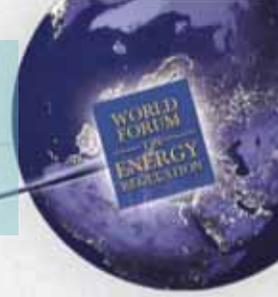
WHY REVIEW NOW – EXTERNAL INTEREST



- **“We are concerned about the direction of UK energy regulation signalled by recent PCR’s. As well as being by far the most complex price control framework we have seen since privatisation, we are concerned that the proposed approach is in our view suggesting a rapid movement towards a rate-based model ... albeit with lower returns than such regimes usually enjoy” - CEO Company A.**
- **“For network utilities the game has changed substantially over the last few years and I believe that we have come to the end of the road on the “easy” opex savings. On climate change the key question is whether network utility regulation should be used as a wider tool – through network pricing or particular access priorities – to secure the climate change agenda” – MD Company B.**
- **Lots of interest externally: SDC, Parliament etc.**

THE COMPANIES GENERALLY SUPPORT A REVIEW

WHY REVIEW NOW – PARADIGM SHIFTS?



- **Better Regulation.**
 - What would the **framers of RPI-X say** now to a process that after 20 years takes 2 years of consultation, taking more data, and arguably starting to lose the ability to identify big differences between companies.
- **Financial**
 - Do the prices paid for network companies suggest a paradigm shift in valuation and/or structure ... or should we be mindful of Dot Com mania?
- **Renewables**
 - Can we hit 33GW connected renewable power by 2020

BIG QUESTIONS REQUIRE CONSIDERED RESPONSES

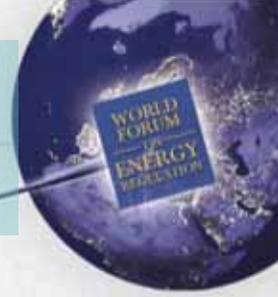
KEY ASPECTS OF RPI-X@20



- **Costing in Shadow Cost of Carbon etc:**
 - Are we fully capturing the value?
 - Why not a RPI-X + E?
- **Assessing the relationships of risk and reward:**
 - Are companies too easily reverting to lowest risk/lowest return approach?.
 - Does TO “lean” on SO’s access to IAE etc.
 - Does the climate change agenda demand a greater incentive for companies to be rewarded for taking risks.
- **More output measures and more ex post regulation.**

ACTIVE DEBATE!

INTERNATIONAL INPUT?



- **Specific Models are very important and greatly welcome...especially Littlechild's work on Argentina, Florida, Ohio and Ontario.**
- **The RPI-X@20 must put network regulation in broadest context:**
 - the push back from markets in USA (see A Buchanan speech to British Economic Association, 25/9/08)
 - the potential to treat network charges as "cushion" for tough times.
 - leads to questions over regulatory independence and cross subsidy.

THERE MUST BE "BEDROCK" PRINCIPLES FOR OFGEM

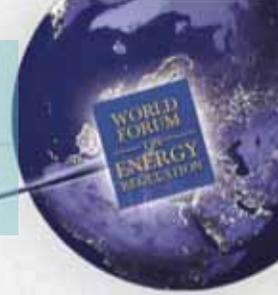
THE RISKS OF THIS REVIEW



- **Capital markets will fear**
 - Retrospective action.
 - Sudden announcements – new directions.
 - Rumour mill.
- **Some comfort**
 - Insulating DPCR5
 - Capital markets will be represented on Ofgem's advisory panel.
 - CC always a route for action.
 - Consultation is in our DNA.

COGNISCANT OF RISKS

OFGEM COMMITTED TO A CAREFUL APPROACH

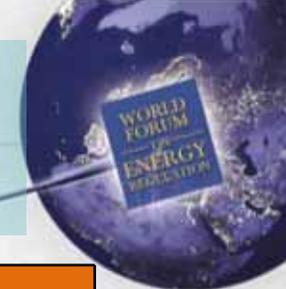


- **Guiding principles**

- (1) "I recognise the importance of stability in the regime and would require a convincing case to be made before proposing radical change"
Stephen Littlechild 1990.
- (2) "Capital market trust is hard won and easily lost" Alistair Buchanan – today.

CAPITAL MARKETS LIKE EARLY WARNINGS

ADVISORY PANEL – RPI@20 PROJECT



CURRENT PANEL MAKE-UP	INSTITUTION/INDIVIDUAL
Steve Holliday	CEO, National Grid
Gina Miscovitch	Fund Manager, Capital Fund Managers
Jim Long	Fund Manager, Ecofin
Alan Brown	MD, Deutsche Bank
Miriam Greenwood	Ofgem NED
Sir Keith Stuart	Consultant (Ex Chair, Seeboard/CEO-ABP)
Dr Simon Taylor	Cambridge University
Ed Mayo	CEO, New NCC (Consumer Focus)
Ed Hosker	Director: Energy, BERR
Ed Humpherson	Assistant Auditor General, NAO
John Davies	Competition Commission*
Phil Bentley	MD, British Gas
Phil Jones	Past President ENA and CEO – CE
Fiona Woolf	Past President Law Society
Dr Michael Pollitt	Ofgem's External Consultant and Cambridge University
Gordon Edge	Director, BWEA
Alistair Buchanan	CE, Ofgem
Steve Smith	MD Networks, Ofgem
Hannah Nixon	Director of Regulatory Review, Ofgem

*John has joined panel on a personal basis.