

Top of the Pops

12 Big Issues in UK infrastructure
regulation: a hit parade perspective

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29 What's it all about, Alfie?

- What are the big issues in UK infrastructure regulation today?
- Will they lead to
 - Better Regulatory Outcomes?
 - Less Regulatory Burden?
- My scoring: \checkmark x or ?

28 Money honey

? x

- Payments Systems Regulator April 2015
 - Duty to promote competition & innovation, and to ensure systems operate in interests of users
 - 21 bn transactions per year, worth £75 trillion pa
- First aim: to ensure unrestricted access to payments systems of the largest banks
 - “we want to break open the control of payments systems” – access & voice for challenger banks
 - Outcome unknown But increased regulatory burden

27 Fly me to the moon

? x

- Rise of behavioural economics at the Financial Conduct Authority (FCA)
 - Why do consumers make wrong decisions?
- Behavioural science, big data & technology
 - “Regulators use vastly more advanced technology than Neil Armstrong used to reach the moon”
 - Modelling 2.3m borrowers, 16m transactions, 50m products ... Regressions on 1 bn data points
- Randomised control trials before acting
 - Eg Bullet points at top of letter tripled response, FCA logo no impact, CEO signature reduced response
- Will trials restrain urge to regulate?

26 Please Mr postman

- Oct 2013 Royal Mail privatised
 - Obligation to provide Universal Service to 2021
- Vigorous access competition
 - Access (collection/sorting only) now 56% mail
- Also beginning of end-to-end competition
- April 2012 Whistl (ex-TNT) E2E London
 - Then deliveries Manchester & Liverpool (alt days)
 - End-to-End (collection/sorting/delivery) 0.6% mail
- RM claimed Universal Service at risk

25 Where did our love go?

√ → X X

- Dec 2014 Ofcom rejected RM's claim
 - And proposed constraints on RM access prices
- May 2015 Whistl put expansion on hold
- Jun 2015 Whistl abandoned E2E
 - The end of End-to-End?
- Jun 2015 Ofcom to review postal regulation
 - To close stable door after E2E horse has bolted?
 - Or to reimpose price controls?

24 It's the same old song

? ?

- 2005 Ofcom Telecoms Strategic Review
 - To make fast broadband widely available
- 2010 superfast broadband policy
 - No cap on price of superfast broadband: incentive
 - But anchor price control on copper network
- 2015 Strategic Review of Digital Comms
 - How to regulate ultrafast broadband?
 - More of the same policy? And deregulate copper?
 - Moving price cap as technologies evolve?

23 The loco-motion

- 1993 British Rail restructured & privatised:
 - Railtrack – all track, signals & stations
 - >100 other cos including 25 Passenger Train Operating Cos, 6 Freight Operating Cos, 3 Rolling Stock Cos, 13 Infrastructure maintenance & track renewal Cos
 - Office of Rail Regulator (ORR)
- Aim: maximise value of declining industry
 - Improved efficiency, more trains run, safest in Eur
- Unexpectedly, demand doubled
 - Economic growth or privatisation & marketing
 - But then needed new investment

22 The runaway train

- 2000 Hatfield accident
 - Speed restrictions because poor maintenance of Railtrack
 - Financial problems, 2001 govt put Railtrack in administration
- 2002 Railtrack became Network Rail
 - Effectively re-nationalised, run by Dept for Transport (DfT)
 - ORR monitors costs, DfT sets contracts, fares, many new invs
 - Treasury capital controls, budgeting, trying to control costs
 - Does NR answer to ORR, DfT, Treasury or train cos?
- Investment plans delayed & over budget
 - West Coast plan 140mph/2005/£2bn actual 125mph/2008/£9bn
 - 2015 £38.5bn investment plan declared untenable
 - but HS2 (£50-70bn) goes on

21 Breaking up is hard to do

$$x \rightarrow \sqrt{\quad} \quad \sqrt{\quad}$$

- 2015 New policy: focus on needs of train operators – and through them passengers
 - Taxpayer funding (2/3 total) to be via train operators who will commission work from Network Rail
 - More power to (regional) route managers
 - “Network Rail shunted towards full break-up”
- ?Split NR into regions? & re-privatise?
 - Train operators each manage their track?
 - Vertical re-integration? Recreating C19 train cos?

20 The long and winding road

- 2015 Highways England[✓] a govt-owned co^X
 - Formerly Highways Agency
 - Gov funded, no borrowing or road pricing
 - More customer facing: delivery of service to users
- 5 yr Road investment strategy + funding plan
 - 3x increase in road spending: feasible? adequate?
- ORR now Office of Rail & Road
 - Duty to monitor delivery by Highways England
 - KPIs, constructive engagement, benchmarking
- On balance a step forward? Yes, but
 - Will regulation of govt body be effective?
 - But possibility of private capital in future?

19 Different strokes for different folks



- CAA regulated 3 London airports 2014
 - Heathrow: RPI-X price cap as before
 - Stansted: proposed monitoring then deregulated
- Gatwick: price commitment in lieu of RPI-X
 - CAA: level should reflect Fair Price ~ price control
 - Airports & airlines would agree bilateral contracts
- Greater flexibility, allows market process
- Basis for future airport investment?

18 Three coins in the fountain



- Civil Aviation Act 2012
- Civil Aviation Authority (CAA) can only regulate an airport if
 - 1 Airport has market power, *and*
 - 2 This could not be adequately addressed by competition regulation, *and*
 - 3 Benefits of regulation outweigh detriments
- CAA argued all 3 obtained for 3 airports
- 2014 CAA conceded not Stansted - worked
- Could apply idea to all regulated sectors?
 - Let Competition Authority not regulator be arbiter??

17 Wasted days & wasted nights

- 2008 Ofgem RPI-X@20 review network regln
- Achievements of RPI-X
 - Efficiency, 30% lower network prices, 30% greater reliability, more investment, rewards shareholders
- Weaknesses
 - Reviews are time-consuming, costly, complex
 - Innovation good but narrow (opex efficiency, finance)
 - Not good in network design, operation & pricing – latter will be more important in future (low carbon techs)
 - No incentive for good business plans: same process
 - Companies focus on Ofgem instead of customers

16 Something old, something new

- New approach needed: RIIO 2009/2010
 - Need innovative, flexible networks to work with suppliers, producers & customers to understand & respond to needs of customers
- **Revenues = Incentives+Innovation+Outputs**
- Revenue: building block & RAV as before
- Incentives: more reward for customer value
 - & from 5 to 8 yrs (with review at 4) - longer payoff
- Outputs not Inputs:
 - Focus on what customers want & get (eg capacity, reliability) not what companies spend & investment
 - Focus on Totex not on Opex & Capex separately

15 Papa's got a brand new bag

- Fast track for well-evidenced business plans with good engagement: 6 v 18 mos
- Competitive network delivery by 3rd parties
 - 2015 comp tender transmission projects > £100m
- Innovation: 3 new funding competitions
 - Modelled on Low Carbon Network Fund £500m
 - New funds open to all – aim to replicate patents
- WACC & Rate of Return on Equity (RORE)
 - All incentives calibrated in RORE, focus off WACC

14 Got my mojo working

- Now 5 years on, can begin to assess RIIO
 - 2012 elec trans & gas, 2014 elec networks
- Output focus & Customer engagement – parties were keen & it worked well
 - Business plans more responsive to customer needs
 - Changed company behaviour
- Totex enabled new/clearer evaluation
 - Led to innovation and cost efficiencies
 - But some concerns about complexity, comparisons, calibrations & about particular calculations

13 Suspicious minds

√ ?

- Fast-track: good rivalry, more info provision
- But only few fast-tracked: 2/4, 0/4, 1/6
 - Ofgem: most biz plan efficiency targets too weak
 - Impact of rejection on incentive to participate?
 - Were the correct companies fast-tracked?
- Funding competitions: active participation
 - But how well can Expert Panel judge best ex ante?
 - Possibility of payment by results instead?
- Revenues: cos still well (over?) rewarded
 - Including via incentive schemes – customer value?
- Ambitious, scope to improve, but promising?
 - How much of this is for the beginner regulator?

12 Keep the customer satisfied



- New emphasis on customer engagement in setting water sector price controls
- England & Wales: Ofwat sought “to put customers at the heart of business plans”
 - Some similarities to RIIO in energy sector
- Scotland: WICS created a Customer Forum
- Enthusiastic & effective participation by all
- More tomorrow ...

11 Come see about me

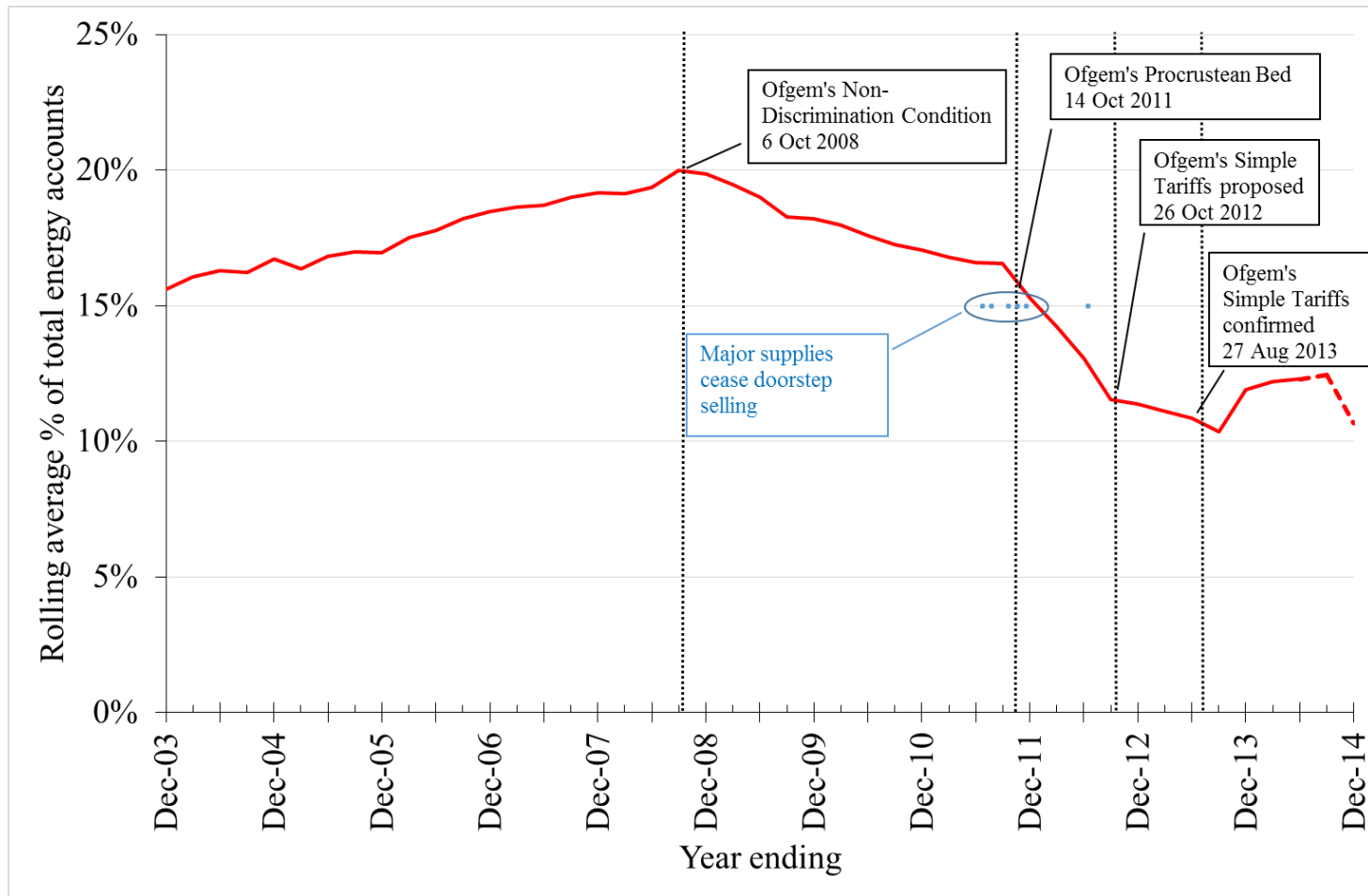
x ?

- UK regulatory appeals process since 1983
 - Involved full reconsideration of all issues
 - Appealing cos could be worse off (some were)
- 2011 energy sector reform per EU Directive
 - Network & anyone materially affected can appeal
 - Including suppliers/retailers & customer groups
 - But can pick grounds for appeal – can they lose?
 - Cf Australian approach that needed revision
- 2015 2 appeals v Ofgem network p controls
 - One by network licensee, one by retailer (BG) –
decs pending

10 You've lost that loving feeling

- 2008 Ofgem volte face on retail competition
 - Glass half full to glass half empty
- 2008/9-2012 non-discrimination policy
 - Banned unfair differentials in prices (in- & out-of-area)
- 2010 restrictions on doorstep (mis)selling
 - Led to cessation of doorstep selling
- Result: customer switching halved
- Supplier profits increased by c £1bn
 - 2007 £110m 2009 £379m 2013 £1148m

9 Please help me I'm falling



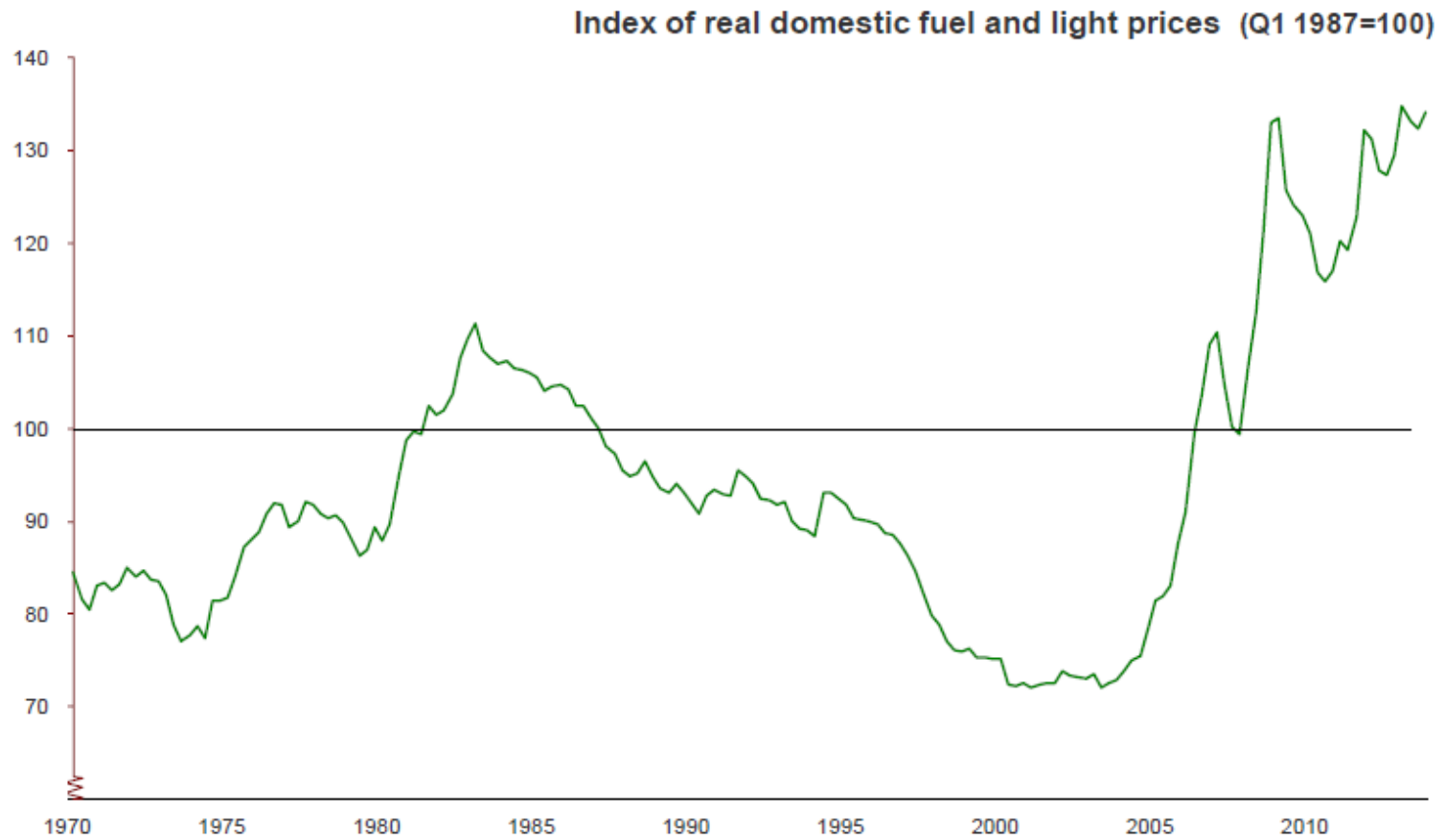
8 Sing something simple

- 2010 Ofgem Retail Market Review (RMR)
 - Market not working because tariffs too complex
- 2011 Ofgem proposed Procrustean Bed
 - All tariffs to have monthly charge + one unit charge
 - Ofgem to set same monthly charge for all suppliers
 - Abandoned 2012 after unspecified difficulties found
- 2013/14 Ofgem's RMR reforms
 - "Simpler, clearer, fairer for customers"
 - Maximum 4 tariffs per fuel per supplier
 - Simple tariffs – eg most discounts banned
 - Suppliers must treat customers fairly (except price)

7 The times they are a-changing

- 2004-9 steepest ever energy price increase
 - Profits not high – but a need to Do Something
- Oct 2008 Govt energy policy interventionist
 - New Act required Ofgem to implement Govt policy
- 2008-2013 Ofgem/GEMA transformed
 - No longer “essentially an economic regulator”
- Fewer/no economists in key GEMA posts
 - 1999-2003: 4, 2003-08: 2, 2009-10: 1, 2011-12: 0
- Fewer biz/financial/econ non-execs
 - 2001-2008: 6/6, 2009-2012: 4/7, 2013-14: 3/7

6 The price of love



Source: Quarterly fuel prices, DECC. Table 2.1.1

5 Well I ask you

- June 2014 Ofgem referred sector to CMA
 - July 2015 preliminary findings
- No problems in these areas:
 - generation market power, vertical integration, liquidity, tacit coordination
- Problems in these areas:
 - smart meter plan but no plan to revise settlement
 - subsidising renewable energy without competition
 - unclear regulatory duty: to promote competition “only after considering a regulatory remedy”

4 Heartbreak hotel

- Retail: customers don't engage enough
- Suppliers raise prices to sticky customers
 - On average prices 5% too high, about £1.2 bn pa
- RMR regulation has restricted competition
 - Customers lost tariff varieties they liked
 - Eg Tariffs with no standing charge, Staywarm
- Tariffs don't seem simpler to customers
- Remedies: prompt customers to engage, & remove restrictive RMR regulations

3 It's all over now

X X

- But these remedies will take time to deliver benefits to disengaged customers
- So a further remedy needed
 - “for those customers who fail to respond to the enabling measures and the prompts”
- “Transitional safeguard regulated tariff”
- Price control with headroom - as in NSW
- So an abandoned Australian price control is now solution for UK competitive market
 - CMA remedy even worse than Ofgem's remedies

2 Bits and pieces

	Better Regulatory Outcomes?	Less Regulatory Burden?
• Regulatory Topic		
• Payments Systems	?	x
• Financial Conduct	?	x
• Post	√ → x	x
• Telecoms	?	?
• Rail	x → √	x
• Road	√	x
• Airports	√	√
• Regulation hurdles	√	√
• Energy RIIIO	√	?
• Customer engagement	√	√
• Energy appeals	x	?
• Energy retail	x	x
• Total	Yes 6 v 3	No 3 v 6

1 Beast of burden

- Are there any common themes in recent developments in UK regulation?
- Regulatory burden keeps on increasing
- Scope for reduced regulatory burden and improved regulatory outcomes where there is less regulation and/or regulation aims to facilitate the market process, not to replace it