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Dear Hannah

Network ‘switching’, competition between networks and the ‘Pollitt’ model

Ofgem’s recent ‘Working Paper 1’ raises the issue of ‘choice of the provider of network services, allowing for switching between networks’.¹ This issue is referenced to the paper by Michael Pollitt on the potential implications of recent developments in telecoms for electricity network regulation.²

Given Ofgem’s continuing interest in Michael’s ideas on inter-network competition, while recognising Ofgem’s conclusions in its Working Paper 2³ that increased infrastructural competition is going to be, at best, a partial answer to providing the networks of the future and while recognising that the sort of competition advocated by Michael is only one way in which competition could be introduced into networks, ENA members thought it would be useful if Ofgem could clarify:

– how relevant, in the next decade or so is a regulatory model which is claimed by Michael himself to be relevant only in a world of the ‘more radical LENS scenarios’;⁴

– what exactly is Michael’s telecoms-based model, how exactly could it work in electricity, and how, in principle, might it be expected to benefit electricity consumers.

On the first point, we understood you to be saying, at our meeting on May 14th, that the foreseeable future is likely to be a world in which the government’s targets for renewable energy would be likely to be predominantly met by ‘big generation’ (especially onshore and offshore wind and nuclear) and ‘big transmission and distribution’ (because of the likely remoteness from load centres of much of this generation). Working Paper 1 does not make any distinction between the likely pattern of generation and networks for the foreseeable future and beyond. In light of this, we were wondering whether it is still your working assumption that some of the ideas for regulatory innovation, which may be relevant in a world of the more radical LENS scenarios, probably have rather less relevance for the next decade or more.

⁴ Pollitt, M. op.cit. p. 3.
However, it is on the second point that clarification would be most useful. We have found it very difficult to determine what exactly Michael is recommending for the regulation of energy networks on the basis of recent experience with telecoms regulation.

Michael’s vision for the future of energy network regulation has three strands:

– facilities-based competition;
– local wire (loop) unbundling;
– buyout of parts of the existing network.\(^5\)

On the first two strands, it is not clear to us whether Michael is advocating anything more, in relation to regulation of DNOs, than appropriately cost-reflective tariffs being charged by the incumbent DNOs to anyone contemplating building their own network. This is obviously an issue on which both Ofgem and DNOs have been spending considerable resources over the last few years, but it is not clear what is added to the debate by the analogy with local-loop unbundling (LLU) in telecoms, especially as Michael admits that the ‘unswitched nature of electricity networks makes the parallel imprecise as one cannot physically reserve the access capacity to the unbundled electricity customer in the same way as in telecoms’.\(^6\)

As regards the proposal that new entrants should have the right to buy DNO distribution assets ‘at fair value’\(^7\), it is not clear either why this would improve efficient operation of networks, or what it would mean for customers who might be connected to such a network and wanted to take supply from those other than the new (local) monopoly owner of the network. In addition, Michael himself acknowledges that the new entrants in telecoms are not exactly queuing up to build next-generation networks, at least on a national basis.\(^8\) One of the implications of Michael’s article is that competitors to BT may be a lot keener on add-ons to the incumbent network than on really major capital programmes, such as those required to deliver the energy networks which may well be required to meet the government’s climate change agenda over the next 10 to 20 years.

In sum, what Michael seems to be proposing is to exploit a technically incorrect analogy with telecoms to argue for a world of (local) vertically integrated monopolies in an energy environment which seems unlikely to emerge for a decade or more. Stripped of the telecoms analogy, what Michael seems to be arguing for is appropriately cost-reflective charges from DNOs to IDNOs—which is less contentious, but also a lot less radical a vision for the future of energy network regulation than Michael’s article seems to be articulating.

It is, of course, possible that we are missing something important here and it would obviously be useful if you could elaborate on the network competition model which it has in mind, possibly when you come to the next meeting of ENA’s RPI – X@20 Working Group on 7 September.

Yours sincerely

Andy Phelps
Director of Regulation

\(^5\) ibid., p. 17.
\(^6\) ibid., p. 18.
\(^7\) ibid., pp.20–21.
\(^8\) ibid., p.22.