

Navigating Through the Regulatory Jungle – Ofgem’s Strategy for Regulating the Future Energy System

The consensus in the energy sector is that to support the transformation to a low carbon, more decentralised energy system we will need a fundamental review of the regulatory framework. The problem for Ofgem (and energy regulators globally) is how to tackle this. If you try to develop the full blueprint for a new regulatory system before doing anything, you will never be able to move. The world will keep changing as fast as your thinking develops. It puts me in mind of the “how do you eat an elephant?” question to which the answer is “a bite at a time”. But if you simply pick off bite size pieces (like embedded benefits) you risk sorting one problem but making things worse elsewhere.

The answer is to ensure that, as regulator, you have at least a high-level vision of all the different parts of the system and where change might be needed to provide context for those individual “bite size” decisions. That’s exactly what Ofgem has now produced in its “Strategy for Regulating the Future Energy System” and as such it deserves to be welcomed as an important step towards a more agile approach to regulation.

It sets out the themes that Ofgem sees as important spanning the role of smart metering, keeping supply and demand in balance, ensuring efficient use and development of network capacity, system coordination and innovation. There is a risk that a strategy can be just platitudes and principles but this does actually dig beneath the surface in a few important areas.

For example, it provides a full list of the factors that create distortions between distribution and transmission (extending beyond network charging into connections and constraint payments) which a number of us were arguing Ofgem should have done before settling on its approach to embedded benefits. It talks about some radically different approaches to network charging such as auctions for access rights (as exist now in gas) – but with a question as to how thinking on that will be progressed alongside the more “incremental” (but potentially still very significant) changes that might come out of the targeted charging review. It touches on cyber security and the importance of knowing who is responsible for what.

Inevitably with a high-level document like this, everyone will have views on areas that are missing. The Future Power System Architect project has highlighted the gap in terms of behind the meter applications and how they are to be managed. They might also have mentioned the wider aspects of system operability from an engineering perspective – the issues aren’t just about energy balancing but reactive power, inertia and so on. Ofgem has recently appointed a new chief engineer but it is unclear what if any input he had to the strategy.

The other weak spot is around gas and heat where the limited references that there are feel like a bit of an afterthought. The main message on gas is that the future is uncertain. What is lacking – and one might have expected in a strategy - is how regulation will cope with that uncertainty. No doubt we will see more of that thinking in the RIIO2 documents in due course. However the original idea (as set out in Ofgem’s corporate plan) was that the strategy would inform RIIO2. Given the first wave of RIIO2 is about gas, the strategy will be of limited help.

That said, the challenges in electricity are more immediate and more complex and Ofgem is right to focus there. This document is a helpful overview of the challenges of regulating for this new world and contains elements that Ofgem might find quoted back at it when it takes its next “bite size” decision. The test then is whether this strategy does visibly underpin future Ofgem decisions – we wait to see.