Sustainability First

New Energy and Water Public Interest Network
'New-Pin'

Workshop 1
Long-term affordability
28th October 2015

This slide-set is not intended for wider circulation please beyond members of the sponsor group and the New-Pin Network

Agenda – 28th October 2015

1	**Welcome, apologies and introductions**	10:00
2	Overview of Sustainability First '*Long-term* affordability' paper	10:05
3	Dealing with future uncertainty: incomes, costs and risks	10:50
	COFFEE	11:50
4	Who should pay for what in the future and how are future costs best recovered?	12:00
	NETWORKING LUNCH	13:00
5	'Managing' long-term affordability – policy, regulation and competition	13:45
6	Possible practical next steps to mitigate long-term cost recovery	14:15
7	Trust and confidence – brief scoping discussion for February meeting	15:10
8	Feedback and AOB	15:25

Agenda item 2
Overview of paper – current context, values & approach

- What do we mean by **long-term**? Looking **beyond** price control periods
- The **current context** is important
  - Affordability is a problem for a significant minority
  - National / regional dimension - Scotland, Wales, SW & S of England
  - More of a challenge in energy? Higher, increasing & more variable bills
  - Problem influenced by changes in cost of other essentials eg housing
- **Values / principles** underscoring public interest in affordability
  - Public acceptability, reasonableness and value for money - not just for those struggling to pay
  - Fairness – intra (among) and inter (between) generational equity
  - Choice and transparency
  - Stability and predictability - planning and budgeting
- **Current approach** – costs recovered through bills. Patchwork of subsidies

Agenda item 2
Overview of paper – indicative projections

	Energy	Water
Infrastructure investment to 2020	£244bn?	£25bn?
Changes in bills (real terms) to 2020	↓ 4 %	↓ 5 %
Changes in bills (real terms) to 2030	↑ 11 %	↑ 2 %
Incomes to 2020	Low incomes ↓ 15% real terms ↑ Pressure housing costs	
Cost recovery	Two thirds of costs will be paid by consumers as bill payers	

Agenda item 2
Overview of paper – future uncertainty

- **Cost drivers**
  - **Sustainability & security of supply**: carbon pricing & wholesale energy costs; water resource levels; 'energy hungry' water; & geo-political risk
  - **Resilience**: replacing & weather proofing aging assets; incomplete asset / asset health data (esp sewerage); impact renewable / smart technologies
  - **Increasing and changing patterns of consumption**: global impacts; population growth; smaller households (renting); impact demand mgt
  - **Finance**: interest rate rises? (esp water)

- **Pace of change**
  - Technological 'lock-in' - '*Delay will increase risks and costs…discounting future welfare is discrimination by date of birth'* (Stern)
  - Tragedy of the horizon - '*Earlier action will mean less costly adjustment…the window of opportunity is finite and shrinking*' (Carney)

Agenda item 2
Overview of paper – different types of future costs

- **Maintenance or 'business as usual' costs** – operational costs & investments needed to renew and repair existing infrastructure to meet current demand

- **Capital enhancement costs** – to extend existing networks to meet known new service demands and the costs of incremental change

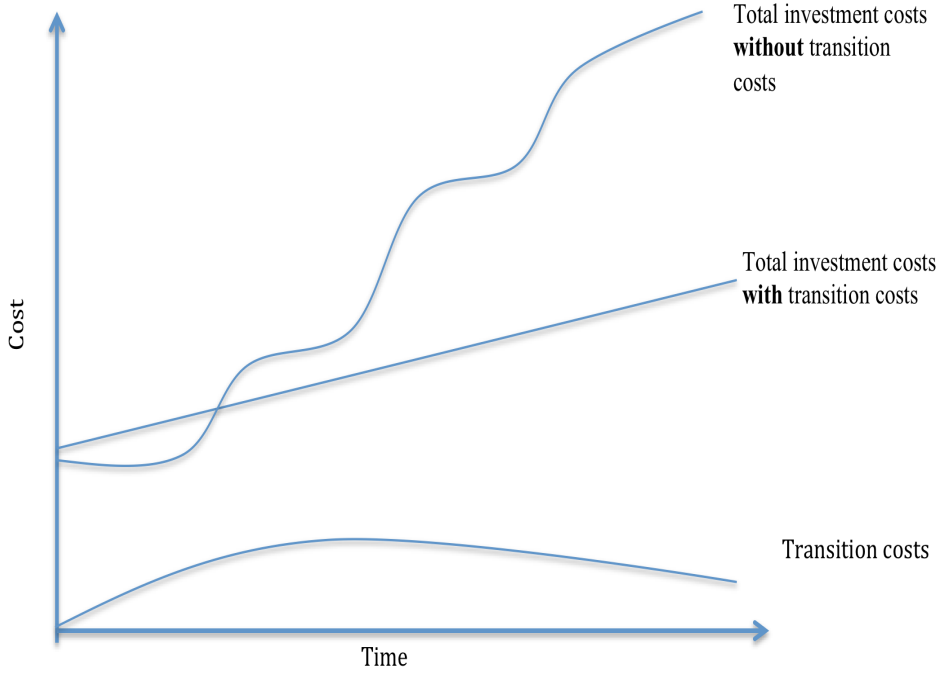
- **Strategic investment costs** – project investment ahead of need before there is a full & immediate demand; a step change in service delivery

- **Natural capital 'repair' and maintenance costs** – ensuring that natural capital is left to future generations in a better state than it was inherited in

Is this list complete? Is it an holistic view of long-term costs?

Agenda item 2
Overview of paper – institutional & organisational transition costs

- Need to recognise these if long-term affordability is to be maximised
- Value in going beyond a project by project approach to cost recovery
- **Rationale** for funding institutional and organisational transition costs:
  1. To enable work around **existing legal and regulatory vires**
  2. To open the way for new actors - particularly **local & demand-side**
  3. To enable **technological and commercial innovation** amongst incumbents



Agenda item 2
Overview of paper – 'straw-man' for discussion

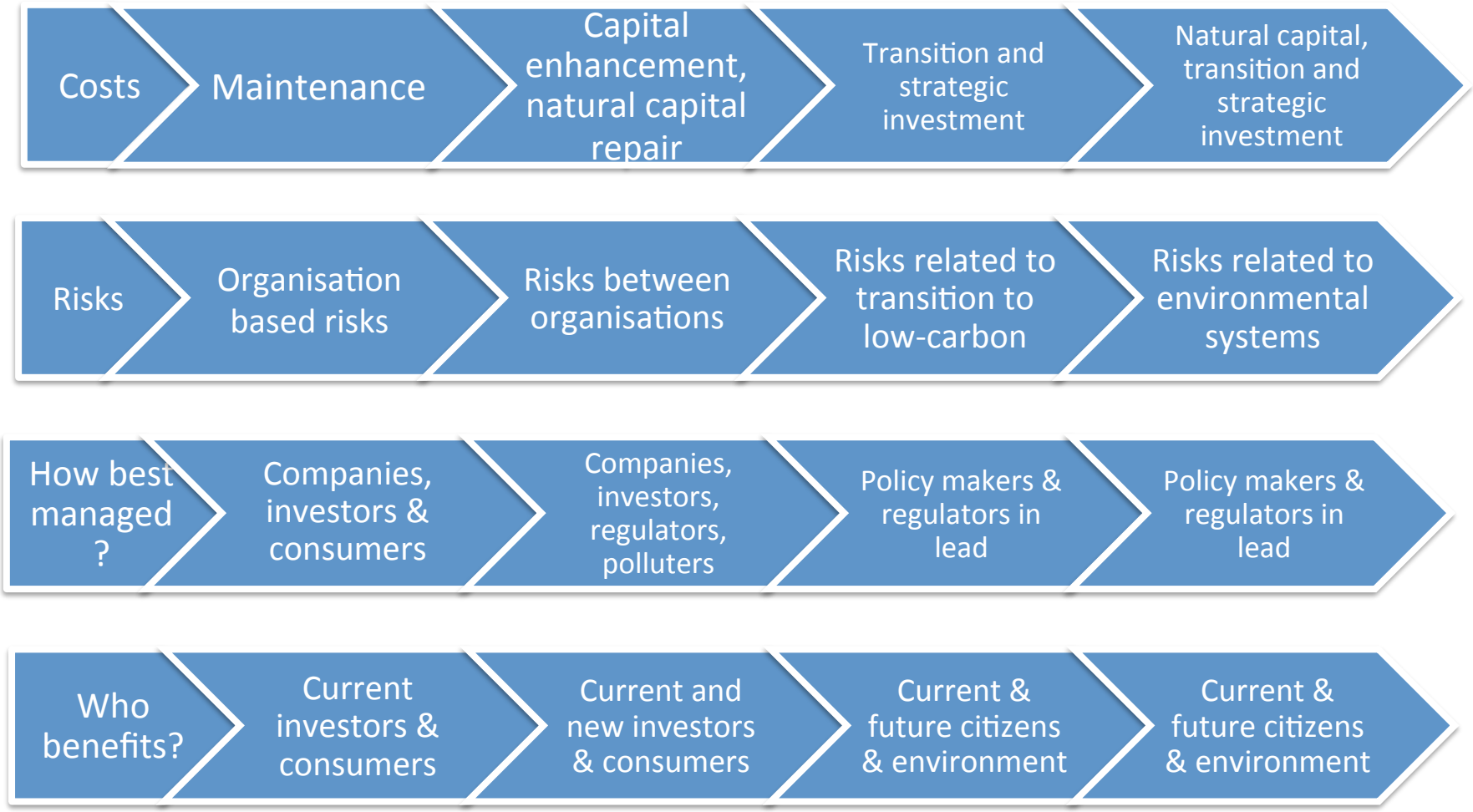
In **principle**, at a high 'macro' level:

- Long-term costs should be recovered from those that benefit from services (be they consumers, citizens or other market actors); *and*

- Are most able to control them and their associated risks

Need to therefore map different costs to different sorts of risks

Agenda item 2
Overview of paper – mapping who may bear costs & risks



Agenda item 2
Overview of paper – 'straw-man' framework for thinking about who pays and how costs are recovered

Type of costs	Degree of uncertainty	Who pays?		Recovery mechanism	
Maintenance costs	Low	Current consumers. Risk and reward sharing mechanisms can help balance who pays between companies / investors and consumers	Current consumers	Current consumer bills (and future consumer bills through depreciation)	Bill payers
Capital enhancement costs		Generality & specific groups of current consumers and developers		Current consumer bills & specific bill payer / developer charges – eg connection charges (and future consumer bills through depreciation)	
Natural capital repair costs		Specific current consumers, citizens, asset owners or developers- if known. If not, possibly taxpayers		Polluter based fines, levies and compensation arrangements (polluter pays principle)	
Natural capital maintenance costs		Mix of current asset owners, consumers, developers & citizens		Mix of current consumer bills (through internalised environmental costs), innovative funding approaches (eg Payments for Ecosystem Services) and taxation if basis of cost allocation is unclear	
Strategic investment costs		If required by legislation, either current generations as consumers or citizens &/or future generations		Either through levies on bills or taxation or through government borrowing	
Institutional / organisation transition costs	High	If to support legislative change, current generations as consumers or citizens &/or future generations	Current and future citizens	Either through levies on bills or taxation or through government borrowing	Taxpayer

Agenda item 2
Overview of paper – levies v taxation

Method of paying for costs	Advantages	Disadvantages
Levies on bills – funded by consumers	• Relatively clear and accountable • Can be part of a predictable framework • By directly impacting on consumers, can encourage more efficient use of services	• Distributional impacts • Consumers may be reluctant to pay for certain activities, potentially leading to under-investment in the future • If changes are made to levies in an ad-hoc way, can undermine consumer and investor confidence
National taxation – funded by citizens	• Can be progressive and minimise distributional impacts • Enables the pooling of risks within and between generations • Could foster sense of public ownership and desire for greater public control	• Could be subject to change as a result of political pressure and electoral cycles • Not necessarily transparent and accountability can be diffuse • Doesn't lead to direct financial incentive to encourage more efficient use of resources

Factors that may help determine the types of projects that should be tax payer rather than customer funded:

- What's the scale of the investment?
- What's the degree of risk?
- Is the investment of national strategic interest?
- To what extent will it have an impact on wider society?
- How far are different approaches progressive or regressive?

Agenda item 3
Dealing with future uncertainty: incomes, costs and risks

1. Do the following values / principles underscore decision making on long-term affordability in the energy and water sectors: public acceptability, reasonableness and value for money; fairness; choice and transparency; and stability and predictability? Is there anything missing?

2. When assessing long-term affordability: i) what expectations should there be about future incomes? ii) should the assumption be 'people will be richer' in the future? iii) how important is it to also recognise that not all people in the future may be richer?

3. When striking a balance between short and long-term affordability, how important is it to: i) take the precautionary principle into account; ii) act now or delay until action is more clearly needed; or iii) prepare for a planned, phased and stable transition to low-carbon?

Continued….

Agenda item 3
Dealing with future uncertainty: incomes, costs and risks

...Continued

4. Is it helpful to divide future costs into maintenance, capital enhancement, natural capital and strategic investment costs (Slide 6)? Is there anything missing? Is this too mechanistic?

5. Do New-Pin members agree that: i) there are specific costs associated with institutional and organisational transition; and, if yes, that ii) although these are currently perhaps most obvious in energy, they are also likely to increase in water; and iii) there needs to be an examination of dedicated ways to recover these costs?

6. Do sector wide, systemic and transition risks require a more joined up approach to policy, regulation and service delivery if long-term affordability is to be maximised?

Agenda item 4 - Who should pay for what in the future and how are future costs best recovered?

7. In principle, at a high 'macro' level, should long-term costs be recovered from those that benefit from services (be they consumers, citizens or other market actors – including shareholders) *and* are most able to control them and their associated risks?
8. Do you agree with the framework for considering approaches to cost recovery outlined in the 'straw man' on Slide 15?
9. Are we clear what the impacts will be of moves from cost socialisation to cost reflectivity on i) market actors; ii) consumers; & iii) is learning currently sufficiently transferred between the sectors in this area?
10. Are certain strategic investment costs better recovered through taxation rather than through levies on consumer bills? Can we be more specific about the types of project that taxpayers may pay for rather than consumers?

Are we clear where we agree / disagree what the public interest is on this topic? Is there any scope for further alignment?

Agenda item 2
Overview of paper – 'straw-man' framework for thinking about who pays and how costs are recovered

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Agenda item 5 - Managing long-term costs Are these the main approaches? Is there anything missing?

- **Policy frameworks**
  - Clear long-standing objectives
  - Getting the balance right between the supply and demand sides
  - Explicitly recognising natural capital costs & enabling a joined-up approach
  - Facilitating the use of transition costs
- **The National Infrastructure Commission**
  - A project-by-project approach to change or infrastructure overview?
- **Strategic investment and competition for the market**
  - 'Open' competitions – technologies and competitors?
- **Regulation and competition in the market**
  - Getting clarity on long-term cost-socialisation
  - Getting the right balance between competition and co-operation
- **Diversification & the potential contribution of different corporate structures**

Note: These issues will be covered in more depth in future New-Pin meetings

Agenda item 6 Practical next-steps to mitigate cost recovery

- **Transparency** eg
  - Greater clarity on who is paying for what
  - Clarity on pace of change / investment trajectory necessary
- **Stability** eg
  - Long-term frameworks – what is missing?
  - Clear trigger points for review of support mechanisms
- **Co-ordination** eg
  - Joined-up picture of long-term affordability pressures
  - Ensuring *overall* distributional impacts are understood, minimised or compensated for
- **Public accountability, oversight & engagement** eg
  - Clear accountability mechanisms for significant long-term expenditure
  - Steps needed to ensure consumer / citizen / public voice in key decisions

Agenda item 6 Practical next-steps to mitigate cost recovery – break-out groups

1. Are these the right **themes** to focus on? Is there anything missing?
   - Transparency
   - Stability
   - Co-ordination
   - Accountability, oversight & public engagement?
2. **Internal next-steps** - what practical next steps could your organisation take to better serve the public interest in this area?
3. **External next-steps -** what may need to change externally to better maximise long-term affordability?
4. **Tools -** can you share / suggest any successful approaches to dealing with long-term affordability with other Network members?
5. **Communication** - how should long-term cost recovery issues best be communicated and to whom?

Agenda item 7 – Trust and confidence – possible key questions for February meeting

1. How do companies establish and maintain trust?
   - Can it be driven by metrics & reporting (eg of **customer satisfaction**) or are **culture**, values & behaviours just as important?
   - What's the role of **brand & marketing** in building trust?
   - Do **transparency** and public **engagement** make a difference?
2. Are energy & water any different here to other regulated sectors?
   - What contribution do **policy & regulatory frameworks** play in developing trust? Is **ownership** relevant?
   - Has **competition** (in energy) eroded trust and led to a focus on the short –term at the expense of long-term **stewardship**?
3. What's the right balance between consumer and investor confidence?
   - What's the role of Corporate Social Responsibility (**CSR**) and Environmental / Social / Governance (**ESG**) reporting?
4. Practical next-steps for the future

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