

Tel: 020 7752 2200
Fax: 020 7752 2128

Chris Chapman
Head of Planning
Office of Gas and Electricity Markets
9 Millbank
London SW1P 3GE



10 October 2003

Dear Chris

Ofgem's three year strategy 2004-7

I refer to Sir John Mogg's letter dated 1 September. EDF Energy is pleased to have the opportunity to comment on Ofgem's examination of strategic choices. It is helpful to know the high-level matters on which you would welcome views and we have aimed to cover them all in our comments below.

In our view, the biggest key challenge for Ofgem and the industry over the period of Ofgem's next Corporate Plan is to create a sustainable environment for long-term investment in infrastructure, of the kind required to deliver security of supply and new energy policy objectives, in a very different market from that of the past ten years. This depends in large part on moving towards a market framework that reduces the need and scope for political or regulatory intervention. The energy sector is capital intensive, with long-term planning horizons. Regulatory stability is crucial to creating the right environment for new investment.

This is particularly the case for the gas and electricity networks, where the key factors in delivering sustainability and security are clear objectives, price controls that have been transparently formulated to provide appropriate investment incentives and balance between risk and reward, and the minimisation of political and regulatory uncertainty. In particular, any failure by Ofgem to allow properly for the significant levels of network asset investment that are likely to be required over the next decade, including an adequate return on capital, could have far-reaching consequences for consumers. We are pleased that these points seem to have been recognised by Ofgem in its recent but still evolving work to produce a generic approach towards network price regulation.

On the retail side, the review of the customer transfer process that is now underway is clearly a major and challenging industry initiative. We are supportive of this because we believe that gas and electricity market participants in general,

EDF Energy plc
Registered in England and Wales
Registered No. 2366582
Registered Office:
40 Grosvenor Place Victoria
London SW1X 7EN

www.edfenergy.com

and suppliers in particular, need to work better together to make the change of supplier experience better for both customers and the industry. A full and active involvement by Ofgem will be critical to the success of this project. It is essential that the development options which emerge from the review should address root causes rather than the symptoms of problems, and that any new investment considered necessary to adapt and improve the industry's registration services and associated processes is fully recoverable by service providers.

Delivery of the government's social and environmental objectives for the gas and electricity industries is clearly a significant challenge and one which affects all parts of the energy supply chain. As a company with significant interests in electricity generation, supply, and distribution, and in gas supply, we expect to make positive contributions to the growth of renewables, the alleviation of fuel poverty, the wider promotion of energy efficiency measures, and the development of more actively managed networks to accommodate distributed generation. But Ofgem, in particular, may have to recognise that the transition to a more environmentally benign energy system cannot be achieved without increases in the price of energy.

This could have substantial implications for Ofgem's approach to regulation. It may be that the historical focus on driving out cost inefficiencies in the network businesses and maximising churn in retail markets has served its purpose. While these were necessary and effective policy tools for their time, they were probably best suited to what can now be seen in retrospect as a period of abundant energy supplies, with a large physical infrastructure inherited from previous periods. Regulatory policies that gave effect to the energy policy objectives of the past are unlikely to provide an adequate basis for the radically restated objectives chosen for the future.

Against this background, it is imperative that Ofgem's decision-making process in its entirety should be informed by robust analysis of the costs and benefits of all major proposals. No significant project or restructuring should proceed unless it is justified on the basis of a regulatory impact assessment that has demonstrated a net benefit to customers, following full stakeholder debate and taking into account all industry costs. At the same time, Ofgem should give greater priority to removing regulatory constraints on competitive markets that have outlived their original purpose but still impose unnecessary costs on participants. We question whether it is still necessary for so much of Ofgem's resources to be devoted to the ongoing management of wholesale and retail markets, given that these are generally perceived to be sufficiently competitive. We also believe that it would be an improvement in governance if there were an effective appeals mechanism in place to enable some of Ofgem's decisions, especially in relation to industry codes and agreements, to be subject to review.

We hope that these comments will assist your review of Ofgem's strategy in the short and medium term, and will be reflected in the shape and contents of the next Corporate Plan. The primary strategic objective must, in our view, be to create a stable and predictable regulatory framework that delivers long-term incentives for adequate investment in both energy production and networks.

We look forward to commenting on Ofgem's draft Strategic Plan in due course.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D. Linford', written over a light grey rectangular background.

Denis Linford
Head of Regulation