



OFGEM PROPOSED CORPORATE STRATEGY 2004-2007

ENERGY NETWORKS ASSOCIATION COMMENTS

INTRODUCTION

The Energy Networks Association (ENA) is the trade body that represents gas and electricity transmission and distribution companies in the UK. We welcome the opportunity to contribute to your Proposed Corporate Strategy for 2004-2007.

This paper provides a broad overview of ENA members' views on the themes that represent the priorities for the next three years. The ENA recognises Ofgem's continuing commitment to consult widely on its future work programme before finalising their strategic plan. In particular we welcome its commitment to undertaking a review to ensure that Ofgem makes best use of its resources to deliver its strategy and meet the challenges it faces in the future.

The ENA agrees with the themes for driving Ofgem's work over the next three years.

GENERAL COMMENTS

The ENA recognises that many of the areas of concern to the Industry require clarity of Government policy objectives. This is particularly true in respect of security of supply and environmental objectives, where it is important to ensure consistency between Government policy and Ofgem initiatives. The ENA believes that Ofgem has an influential role in advising Government on the practical implications of policy proposals, as well as in developing the more specific incentives that should ensure delivery of these objectives.

In addition to this, we are concerned about some of the delivery mechanisms associated with implementing the environmental objectives. In particular, the ENA believes that the current planning and legislative framework will severely impact the ability on the industry to deliver robust and efficient electricity networks on time to meet the renewable energy targets. Therefore we believe that a new approach is required to the framework regulating the delivery of new major electricity infrastructure schemes. Although Ofgem has no direct control over this issue, we believe that it needs to influence the Government thinking on this constraint to help the Network Operators deliver their objectives. However we do note the proposed

changes to the planning framework included in the Energy Bill and hope this will impact positively on these infrastructure schemes which are designed to meet, in particular, the Government renewable energy targets.

The ENA recognises the significance of new European legislation. However, we hope that Ofgem will be able to influence developments in this area, which has an increasing influence on the energy sector, in a way that minimises any additional burdens on the energy industry in the UK.

DETAILED COMMENTS

Regulating Network Monopolies

Incentives to Invest – Electricity Networks

The ENA welcomes Ofgem's commitment to developing the correct incentives for investment into the network and making the next distribution price control a key priority for the coming year. As your paper highlights, the new framework needs to improve incentives to invest, maintain security of supply and accommodate renewables and distributed generation. However, we note that the need to invest focuses on the environmental objectives rather than in a broader sense. Whilst there is a firm recognition of the need to accommodate distributed generation, we would like to see a stronger acknowledgement of the general need for investment in an ageing infrastructure. This is important in terms of long term sustainability of the network, storm resilience and therefore security of supplies and the interests of consumers.

Electricity Distribution

The ENA recognises that Ofgem has already been working on improved investment incentives on Distribution Networks Operators (DNOs) to encourage the growth of distributed generation. However, the ENA would like to emphasise a number of key issues affecting our members.

The key factor in relation to this issue is that installation of large amounts of distributed generation will place a significant strain on distribution networks that will have to be overcome by introducing new design and operating procedures whilst still maintaining the high level of supply quality and reliability that customers in the UK have come to expect.

In order to move to this more dynamic method of operating distribution networks it will be necessary to revise the current regulatory framework, to incentivise DNOs and provide them with the stability that will be required to support long-term investment decisions. This would provide the correct signals for DNOs to invest in upgrading their networks to maximise the capacity to accept more distributed generation.

ENA members believe that co-ordinated action by all of the major stakeholders will offer the least time-consuming and most cost-efficient method of achieving

Government targets. This approach will help ensure that we make use of suitable sites and areas where the existing infrastructure capacity is already available. Where this is not possible, for example offshore wind, it will be necessary to extend the existing networks significantly.

ENA members believe that the introduction of the correct commercial and regulatory framework is the single most important factor affecting how Network Operators can support the Government's target for renewable and energy efficient generation. This is one of the key issues for the next distribution price control review and also for transmission network owners, who will have existing controls extended to April 2007.

Given the degree of uncertainty over the likely costs arising from the connection of additional distribution generation, there is a clear need for a flexible mechanism that could mitigate risk, while providing DNOs with a positive incentive to act. Therefore we are pleased that Ofgem recognises the need for a clear, transparent and predictable framework that is not too rigid in the face of such uncertainties.

ENA members would ask Ofgem to ensure that work continues on key issues within appropriate timescales, which requires co-ordinated, long-term investment programmes, supported by a regulatory framework that allows such programmes to be implemented.

Electricity Transmission

As Ofgem acknowledges, the UK geographical areas which offer the most potential for renewables are often remote from a suitable electrical network. The Transmission Issues Working Group has identified a need to upgrade the transmission system to support the movement of large power flows around the country, particularly for generation in Scotland and the North of England where this generation will compound the already heavily loaded North-South transmission system power flows. At present, for various reasons, transmission system operators (TSOs) do not have the required regulatory certainty to invest in the necessary upgrading. The development of generation without upgrading the transmission networks will lead to significant congestion and high constraint costs. Further congestion will arise if network upgrades are undertaken only in response to generation developments because construction outages are likely to be significant.

For transmission developments, there is a need to establish a framework in which cost recovery for required investments can be assured. ENA members therefore advocate a co-ordinated approach so that network capacity is established in a timely manner to accommodate generation requirements. Although we are pleased that Ofgem recognises that future price controls on electricity transmission will need to provide incentives for investment, as your paper highlights, some investment is required now and we hope work will continue on developing mechanisms to address this.

Responsive to customers

The ENA notes that Ofgem is considering incentives for improving services to customers and a specific objective of introducing clearer incentives for improved performance in the event of severe weather. We hope that this price control review will develop clear links between allowed income and the delivery of services that meet the needs of customers and Government. The ENA would like to see the development of a better-defined framework for quality of supply. However, any target setting needs to take account of the inherent variability in network performance. We believe that any revised incentives should be informed by research on customers' requirements and willingness to pay for improvements. Once standards have been set, network operators can be incentivised to meet those levels of performance consistently. Although this is a difficult area the debate will continue until there is greater clarity over both standards and the means of measuring performance.

Improving Ofgem's Efficiency and Effectiveness

The ENA welcomes Ofgem's adoption of the principles of better regulation, including the introduction of Regulatory Impact Assessments (RIAs) and hopes that this may continue for all major areas of work being undertaken by Ofgem.

We appreciate that it is not always easy to quantify the benefits. Nevertheless where regulation imposes significant costs, it is crucial that a cost-benefit analysis is carried out. We believe it is of utmost importance that the costs to the Industry are considered before regulatory projects are initiated and are pleased that Ofgem will seek to engage industry and customers in the RIA process as they are often better placed to identify such costs.

The ENA also welcomes Ofgem's commitment to reviewing the way it works in order to identify new ways to lower its costs as well as its commitment to keeping costs in 2004/05 within the budget figure of £34m proposed in the March 2003 Corporate Plan. However we are still concerned about the level of staff numbers and costs involved in energy regulation, which are continuing at a much higher level than justified. This is despite the withdrawal of regulation from many areas where it is no longer necessary. We therefore support Ofgem's further withdrawal from regulation in some areas, for example, by removing certain licence conditions. We would also like to see a more focussed approach on the key priorities highlighted in this strategy paper as it would allow resources currently being spent on less important issues to be better utilised.

We look forward to seeing Ofgem's detailed deliverables and targets in the draft Corporate Plan which will include a 'fresh look' at its priorities.

CONCLUSION

The ENA welcomes the publication of Ofgem's draft strategy and the themes representing its priorities for the coming three years. In summary the key points for the ENA arising from the proposed strategy are:

- ENA supports a change to the regulatory regime in respect of the Distribution Price Control which focuses on investing in longer-term asset replacement to safeguard the future availability and resilience of the network.
- In respect of Transmission we advocate a co-ordinated approach so that network capacity is established in a timely manner to accommodate generation requirement.
- We support the further development of RIAs which should include a cost benefit analysis for all major projects.
- We support further withdrawal from areas where regulation is no longer needed and a review of Ofgem priorities and costs.