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4 February 2004

Dear Chris

**Ofgem Proposed Corporate Strategy 2004–2007**

I refer to the document under the above title published on 7 January. We found it to be clear, well presented, and helpful and I attach some comments on the contents, section by section. In this covering letter, I want to give our views on Ofgem's overall approach to its task.

**Customer interests**

As the document reiterates, Ofgem's primary duty is to protect the interests of customers. We, too, are always mindful of their needs. In particular, we feel that, when Ofgem is contemplating some regulatory or market change, greater effort should be made to seek the views of customers, especially as a key input into regulatory impact assessments. In doing so, special attention must always be paid to the interests of vulnerable customers.

**Better regulation**

We are pleased to see set out in the document a clear commitment to better regulation. We are committed to developing a long-term, sustainable business and it is vitally important to us that Ofgem maintains regulatory consistency and predictability. This will minimise regulatory risk, which can unnecessarily add to costs and therefore prices.

It seems to us that the opportunity should be taken to restate the role of truly independent regulation for the energy sector now that fully competitive markets have been created in the UK. We take the view that energy is an essential product and particular issues arise about security of supply, energy efficiency, and fuel poverty. Government will inevitably develop policies in these areas and these will have an impact on companies and their customers. We see Ofgem playing an essential role in this process, which must be much more than to help government to implement those policies.

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It is important that Ofgem, from a position of independence, advises government on the impact of its policies, taking into account its statutory duties. Any development of regulatory rules and market mechanisms must avoid distortions to markets and encourage long term players in the industry to invest for the long term. As a key example, what has become the traditional five year cycle for network price control reviews should always take into account the longer term and therefore ensure maximum continuity in regulation from one period to the next. What is of fundamental importance is the financial health of network owners, and regulation should aim to avoid undue fluctuations in cash flow and gearing as a result of periodic price control reviews.

### **Supply competition**

We accept that in order to develop supply competition it was necessary to achieve a degree of functional unbundling and this is now embodied in the European directives. However, this has been at some cost and companies have had to work hard to ensure that continuity of customer service is not unduly damaged. As a vertically integrated company, we are acutely conscious of this need and, while complying with our licence obligations and being careful to avoid any damage to competition, we aim to exploit links between businesses where this will benefit customers. We would urge Ofgem to continue to recognise the benefits of vertical integration, in the context of competitive generation and supply markets.

### **Key principles**

While not dissenting from the key themes contained in the document, we also feel that Ofgem's work over the next three years would benefit from adopting a small number of key priorities. We would suggest that these are to:

1. Share and support the responsibility of licensees to enhance service to customers.
2. Create a sustainable environment for long term investment in infrastructure.
3. Assist government in achieving social and environmental objectives cost effectively and in ways that safeguard security of supply.
4. Remove where possible any unnecessary regulatory constraints on competitive markets.
5. Carry out regulatory impact assessments for any proposed regulatory or market change.

We are committed to working constructively with Ofgem and look forward to considering Ofgem's more detailed corporate plan.

Yours sincerely



**Denis Linford**  
**Head of Regulation**

## **Attachment to letter dated 4 February 2004**

### **EDF Energy comments on themes and approaches**

#### **1. Creating and sustaining competition**

##### **Wholesale markets**

We fully support the introduction of common trading arrangements for Great Britain by April 2005 and we want to contribute more closely to delivering that objective. To that end, we urge the creation of an overall steering group with GB-wide industry representation to oversee the implementation of BETTA.

We share Ofgem's concern about the lack of fully developed competition in the European gas markets and will support any appropriate reforms to increase competition there. We consider that this is particularly important because of the increasing influence of gas prices on electricity prices via the role of gas-fired power stations in the UK generation mix.

While there is clearly a role for Ofgem in effective wholesale market monitoring, this should not be such as to inhibit the operation of the price mechanism to balance supply and demand and indicate investment incentives.

We support Ofgem working with government to enlarge available information about offshore gas production and believe that there is scope for the DTI, in particular, to show greater leadership in this area.

We remain concerned about the scope and size of Ofgem's role in governance arrangements for competitive energy markets. The fact that almost no significant rule change can take place there without Ofgem's approval makes it all the more important for market participants to have effective rights of appeal.

##### **Retail markets**

We support more collaborative work between Ofgem and the industry to improve customer experience of the transfer process. However, instead of the proposed emphasis on closely examining how suppliers market their services, we consider that Ofgem's focus would be better directed at researching customers' views on the quality of the transfer experience and how it might be improved.

The constant rule for Ofgem in considering its role in retail markets should be to work towards greater deregulation and reliance on industry self-governance and general consumer law.

##### **Industry structures**

We agree that there should be continuing assessment of the customer benefits of structural changes in the gas and electricity industries and that the proper test of such changes should usually be whether they facilitate the introduction or enhancement of competition. It is clear, for example, that vertical integration can bring significant benefits to customers and is entirely consistent with effective competition.

We support the further assessment of the costs and benefits of any proposal by NGT to sell one or more of its gas distribution network businesses. No such disposal should be approved by Ofgem except on the basis of a published impact assessment demonstrating a positive net consumer benefit beyond any reasonable doubt. If the project then goes ahead, the regulatory, commercial, and operational arrangements must be fully worked out first.

It is increasingly clear that Ofgem should reconsider the costs and benefits of competition in meter provision and meter operation and of further developing competition in connections. These projects have been allowed to consume significant amounts of Ofgem and industry resource over the past three years, with little if any discernible benefit to consumers, and have at no time been subject to proper regulatory impact assessment.

## **2. Regulating network monopolies**

We support the further development of incentives on outputs, and believe that this can be achieved alongside the necessary introduction of a clear and predictable framework that deals properly with uncertainty. Incentives to invest must recognise the sharper pressures arising now from the asset replacement cycle and also the unpredictable cash-flow impacts of growth in distributed generation. We are sceptical about the value of developing market-based access arrangements in transmission, particularly for exit rights.

## **3. Security of Britain's energy supplies**

In principle, we support Ofgem's emphasis on allowing energy markets to deliver security of supply. However, it remains unclear whether the current market arrangements will prove capable over time of signalling a reward for capacity that is sufficiently strong to bring forward longer-term investment. Monitoring and greater transparency of market operation are therefore vital.

Ofgem should also work with government to ensure that security of supply is not compromised by environmental measures. In particular, this may require a more serious consideration, going forward, of the technical and operational implications of the government's wish to keep the nuclear option open.

## **4. A leading voice in Europe**

We support Ofgem's aim to influence and shape the regulatory debate about energy policy in Europe. It is common ground that developments in European energy policy should favour the swiftest possible development of markets and market mechanisms.

However, we would be concerned if expertise and resources that could be more usefully deployed to monitor the operations of (particularly) the domestic UK energy markets were to be diverted into work to "influence key member states' implementation of European legislation and regulation" (paragraph 5.6). It is not clear that such work falls properly, if at all, within the scope of Ofgem's statutory duties.

It is also unclear that “monitoring of [European] ownership and market structures to prevent market liberalisation efforts from being undermined” (see paragraph 5.7) is an appropriate role for Ofgem, particularly given the known position of the European Court of Justice that “exceptions to the principle of free movement of capital and, consequently, to the principle of freedom of establishment can be justified only if the objective pursued falls within the ambit of a general or strategic interest and the measures prescribed are based on precise criteria which are known in advance, are open to review by the courts, and cannot be attained by less restrictive measures”.

## **5. Helping to protect the environment**

We welcome Ofgem’s increasing responsiveness to the broader environmental policy context of its work. We particularly support the view that the implications for electricity transmission and distribution networks of increased renewables in the national generation mix will be of major importance in the setting of future price controls. We are surprised, however, to see no emphasis on the need for Ofgem to give full support to the energy services trial by promptly making the necessary regulatory changes.

## **6. Helping to tackle fuel poverty**

We note that the DTI’s statutory social and environmental guidance for Ofgem includes specific reference to the government’s fuel poverty strategy. That strategy, which aims to eliminate fuel poverty among vulnerable UK households by 2010, is very ambitious given the higher prices that will be an inevitable consequence of the transition to a more environmentally benign energy system. We support workable measures to alleviate the effect of higher energy prices, for example through improved debt management, provided that they do not create cross-subsidy, which is a matter for government legislation.

## **7. Improving Ofgem’s efficiency and effectiveness**

We note that Ofgem’s draft corporate plan, to be published alongside the final strategic plan in March, will contain detailed deliverables and targets against which future performance can be assessed and may consider whether some areas of work can be abandoned or delayed. We look forward to responding to this welcome development.

As a general rule, Ofgem remains too busy as a regulator, persistently claiming as mandatory large areas of work and activity that are in fact discretionary. To be told (at paragraph 8.5) that as evidence of its commitment to give value for money Ofgem proposes to spend no more in 2004–05 than was previously budgeted does not inspire confidence. We wish to see a regulatory organisation that is slim and skilled and applies a joined-up approach to regulation.

**EDF Energy**  
**04.02.04**