

4th February 2004

Chris Chapman
Head of Planning
Ofgem
9 Millbank
London SW1P 3GE

Dear Chris

OFGEM'S THREE YEAR CORPORATE STRATEGY 2004-7

Thank you for the opportunity to comment on Ofgem's draft three year corporate strategy as set out in the consultation paper published in January 2004.

British Energy notes that within the paper Ofgem has identified seven themes that represent its priorities for the coming three years. In principle, we consider that these themes appear to reflect the right focus of the Authority over the strategic review period. However, the key challenge for Ofgem will be to strike the right balance between sometimes conflicting priorities in order to satisfy its principal objective of protecting the interests of consumers. The achievement of this aim will lead to greater regulatory certainty and stability which in turn will create the right environment for long-term investment.

With respect to the actual objectives contained within the themes we would offer the following views.

Creating and Sustaining Competition

We are pleased to note that the draft strategy outlines Ofgem's commitment to devoting the resources necessary to implement GB-wide trading and transmission arrangements by April 2005. **However, it is imperative that these resources focus on delivering practical and deliverable arrangements and avoid the temptation to deliver, in parallel, fundamental reform of existing market arrangements in the absence of justifiable benefits.**

Furthermore, we note that Ofgem will continue to assess structural developments in the market in terms of impact on customers and competition. In our response to the original consultation we expressed concern regarding the developments in market structure and in particular the significant increase in vertical integration and market power within the sector. Evidence suggests that this trend is having a distorting effect on competition in both the generation and supply markets. **Consequently, we firmly believe that an open and comprehensive review of the issues surrounding VI should form part of Ofgem's strategy under this theme.** Such a review should include an examination of the effects of increasing VI on competition in generation and supply markets and the apparent uncompetitively high margins being achieved by these VI players in the domestic supply market.



On this issue we note that the DTI, in its response to your original consultation shares similar concerns regarding the state of competition in the domestic supply market and in particular the failure of domestic suppliers to reduce in-area prices. It too is pressing that Ofgem's strategy should address these issues.

Helping protect security of Britains energy supplies

The issue of security of supply has clearly risen up the political agenda. For example, there has been a significant amount of focus/concern on generation capacity levels for the current winter period. It appears from this that there are wide-ranging concerns regarding the ability of the market alone (since the introduction of NETA) to deliver security of supply. We have advocated for a review of how, and whether, generators are sufficiently incentivised to maintain spare capacity and thus maintain the appropriate plant margin deemed necessary by NGT.

However, it would appear from the draft strategy that Ofgem are only proposing to continue to monitor the situation. We do not consider this to be sufficient. The operation of a transparent and properly functioning market that provides appropriate signals to new entrants and existing players on investment time-scales is crucial to ensuring security of supply and hence protecting the interests of consumers. Therefore, given the concerns expressed above, **we continue to press for a full and public review of the security of supply arrangements and consider that this should be one of Ofgem's key objectives in the short-term.**

Improving Ofgem's efficiency and effectiveness

We are aware that Ofgem are making improvements in the way it regulates the industry. For example, the adoption of regulatory impact assessments is a much welcomed improvement to the existing governance arrangements. However, there remains a great unease with the current governance arrangements particularly in respect of Ofgem's role in the industry code modification process. This concern has been exacerbated by recent events in respect of the implementation of zonal transmission losses in England & Wales (P82) and the eventual quashing of the Authority's decision by the High Court.

It is clear that in order to improve investor confidence and reduce regulatory uncertainty greater transparency is needed in the way in which the Authority/Ofgem arrives at policy decisions. **One such improvement, which we have recommended previously, would be to publish more information in respect of the proceedings of the Authority.** Apart from information regarding the composition of the Authority and the general Rules of Procedure, no other meaningful information is available. This is not conducive to open and transparent regulation. We would therefore urge the Authority to publish more information regarding its proceedings including perhaps dates of meetings, meeting agendas, attendance and a (non-confidential) summary of the minutes of meetings. In addition, where final or preliminary decisions are published it could usefully be made clear whether the decision has been made by the 'full' Authority or not.



In addition, we are also concerned that Ofgem is failing to consistently apply its aim of demonstrating a sense of continuity, coherence and predictability in the way it develops market reform. An example of such inconsistency in approach is clearly demonstrated by the decisions taken by Ofgem in respect of the access criteria for the Scotland-England Interconnector compared to those taken in respect of the implementation of zonal losses in England & Wales. In both cases there were compelling arguments for not implementing fundamental reform prior to the commencement of GB-wide market arrangements as the perceived benefits would only accrue for a short period of time. However, Ofgem's response to the same compelling arguments in each respect were very different. This unpredictability only goes to decrease regulatory certainty and stability which in turn creates an unhealthy environment for long-term investment.

I trust you will find these comments helpful I would be happy to clarify any aspect of our response with you should you wish.

Yours sincerely

David Love
Head of Regulation

Direct Line: 01452 653325
Fax: 01452 653246
E-Mail: david.love@british-energy.com