

Ofgem's Corporate Strategy 2004-2007  
Response from the Association of Electricity Producers

04 February 2004

The Association welcomes the opportunity to comment on Ofgem's strategy and its commitment to public discussion of its Strategy and Business Plan. The Association (AEP) is the trade association for the electricity generating industry in the UK. Its membership of some 100 includes all the major generating companies and a wide range of other generating businesses. Between them, the members represent virtually all of the generating technologies employed commercially in the UK. Through payment of their licence fees, the Association's members make a large contribution to the cost of running Ofgem.

We are disappointed that the draft proposals represent a timid reduction of the high costs of the regulator and urge the new brooms to sweep more thoroughly as they review the organisation they have inherited. We applaud Ofgem's aspiration to be guided by the key principles of **better regulation**. One of the other important issues addressed by the Better Regulation Task Force was the problem of transparently prioritising potentially conflicting regulatory obligations. We believe Ofgem needs to make clear how this will be done. The announced implementation of Regulatory Impact Assessments for 'significant' modifications and policy initiatives is a step forward and should provide a vehicle for resolution of the prioritisation issue. Nevertheless, it is not clear how Ofgem intends to deal with the difficult issue of prioritisation of objectives.

The separation of the roles of Chief Executive of Ofgem and Chairman of the Gas and Electricity Markets Authority is a move towards a healthier governance model. We look forward to the Authority providing more robust challenge to Ofgem's proposals.

It is surprising that no mention is made of the proposals for appeals to Ofgem decisions. Other matters dealt with in the Energy Bill are discussed in the Strategy. How does the Authority plan to deal with this operationally? We would anticipate that this should be addressed in developing the RIA framework.

We make a number of detailed comments below that are referenced to the paragraphs in the document and look forward to responding to the detailed business plan when that is consulted on later in the year.

Detailed Comments

<u>Para No.</u>	<u>Comment</u>
1.5-1.7	Sets out the statutory responsibilities, but does not indicate how Ofgem will prioritise them.
2.3	Post the implementation of BETTA we would expect to see a significant reduction in resource requirements. Also, the creation of the common GB arrangements should allow further reduction in resource as Ofgem achieves the resultant economies of scale and scope.
2.2-2.9	In previous Ofgem business plans, 'making markets work' has had the largest slice of resource. After over a decade of wholesale competition we believe it is time for a 'zero-based' approach to reviewing the continuing high level of resource with a view to substantially reducing it.
2.8	We applaud Ofgem's commitment to dealing with modification proposals 'quickly and efficiently'. We suggest Ofgem adopt operational goals for reaching such decisions, as there is a cost to market participants of delay and uncertainty. The recent shambles regarding the P82 decision process leads us to query what processes and procedures are in place to ensure high quality decisions are

- reached quickly and cost-effectively. We suggest Ofgem volunteer to undertake a process audit with a view to improving their internal methods.
- 3.2 We note Ofgem's commitment to incentive regulation. For monopoly providers such as System Operators, international benchmarking might be considered, although we recognise that it will have its limitations.
- 3.9 This note focuses on the requirement for 'investment to be undertaken efficiently'. We would suggest that the outcome of the investment, its cost and benefit are worthy of greater scrutiny than just the process of investment.
- 3.15 In common with many industry participants we are prepared to consider longer term incentive arrangements for the SO, but believe this would best be done after BETTA has bedded down. NGT has no experience of operation of the Scottish networks as yet. Therefore this initiative should be delayed.
- 4.2 Noting the reference to market abuse in California, we trust this is not an attempt to revive the discredited idea of a 'Market Abuse Licence Condition'. We believe government and the Competition Commission have already spoken clearly on this matter.
- 4.6 We believe the work of JESS would benefit from more direct involvement by industry participants. The current amendment to the Grid Code is ill-conceived and lacked early industry input.
- 4.7 We infer that the effect on security of supply will be one of the prime considerations of the promised Regulatory Impact Assessments. How does Ofgem intend to develop its RIA framework?
- 4.8 In our experience, recent years have been characterised by slumps in the sale price of generating plant, exit of American investors and the need for support of a major generator. Ofgem's description of the market seems a little rosy to say the least. Nevertheless, the Association is not advocating further regulatory intervention, and indeed considers the scale and scope of current intervention to present a significant risk to new investors.
- 4.9 Ofgem's comments about improving security of supply appear to make this criterion pre-eminent. Is this correct?
- 4.12 Whilst the provision of information to NGT may have been one of the espoused goals of long-term auctions, the jury is still out as to whether it will provide it, or whether it is an efficient means to collect it.  
The auctions themselves should have no effect on 'reducing the time it takes NGT to deliver extra capacity'.
- 5.5 We support Ofgem's proposal to become more involved in the European debate and applaud the commitment to establishing liberalised electricity and gas markets in the wider Europe. In pursuing this agenda, Ofgem should consult GB industry participants and should keep the industry regularly informed on developments within CEER and the European Regulators' Group. We do not believe that this work requires any increase in Ofgem's resource base, rather a re-prioritisation away from aspects of the domestic agenda.
- 5.6 The Association supports the use of market mechanisms as a means to deliver energy policy objectives such as security of supply. Nevertheless, we think that the UK's debate on security of supply has some way to run> Ofgem should therefore make an effort to learn from best practice in other markets as well as conveying the merits of the UK's approach.
- 5.7 We would like to see clarification of this paragraph. With the UK becoming more interconnected with the European system, it is clear that competitive market structures on the continent will become increasingly important for the UK. However, monitoring of the market among other member states could easily become a resource-intensive activity and does not appear to come within Ofgem's remit.
- 6.3 See earlier comments regarding prioritisation of potentially conflicting

obligations. How will this be resolved?

- 6.5 The Association would like to see Ofgem committing to administer the Renewables Obligation in a manner which will secure the best value to customers. The cost of the Obligation is tightly ring fenced by the buyout price and recycling of buyout payments. In order to secure best value for customers, it is necessary to achieve the highest level of development of renewable energy projects from the policy mechanism. This requires Ofgem to administer the Obligation in a manner that will achieve maximum effectiveness of the policy and give maximum confidence to market participants and potential investors. We note Ofgem's plan to advise Ministers about the design and implementation of the EU Emissions Trading Scheme and any other trading schemes for emissions. The Association would like to stress the importance of ensuring that the market mechanisms for such schemes are robust and that they provide security and confidence to market participants. For a trading scheme to work, participants must have confidence in the market mechanism itself.
- 6.11 We note your comments about reduction of losses from transmission systems. We note that NGT already receives a payment in its SO Incentive scheme related to the value of losses. We trust there will be no double counting in any proposals.
- 7 The Association recognises the political importance given to the issue of fuel poverty and comments only that a competitive wholesale market helps to keep down retail prices.
- 8.1 We reiterate that Ofgem's costs are too high. The international benchmarking carried out by the European Commission demonstrates this beyond reasonable doubt. Ofgem's budget is three times that of regulators in markets of similar size and staff numbers are between twice and four times as large. We welcome the introduction of the RIA. We look forward to understanding how it will be implemented. However, between now and the Royal Assent of the Energy Bill industry participants will have to deal with three separate consultations for all significant modifications: the normal E&W consultation, the consultation to address GB issues, and the RIA. This represents death by consultation is not a good indicator of an efficient cost-conscious regulator.
- 8.2 Whether or not £36m is 'relatively small' is only part of the issue. No less important are the direct and indirect costs for the industry and its customers.
- 8.4 Industry participants are dismayed by the P82 process. We believe Ofgem should undertake an operational audit to ensure its decision making processes deliver quality decisions in a timely and cost-effective way.
- 8.6 We applaud all of the intentions expressed here and look forward to their concrete achievement. How will Ofgem measure success here?
- 8.7 We look forward to the reasoned abandonment or delay of work being signalled in the Business Plan.