

Responses to Ofgem's Proposed Corporate Strategy 2004–2007

Introduction

- 1.1. Ofgem's Corporate Strategy 2004 – 2007 sets out the key themes on which we will focus over the next three years. It follows a consultation on our draft Strategy, published in January 2004. We are very grateful to those who took the time to respond and offer their thoughts and views on our draft Strategy.¹ The final Strategy that we are publishing today follows careful consideration of these responses, and development of the key themes set out in the draft. We are also publishing today a detailed corporate plan for consultation—this has also been developed in light of the responses to the draft Strategy.
- 1.2. The Strategy contains seven key themes that represent our priorities for the coming three years. The main points raised by respondents in relation to each of these themes are discussed below.
- 1.3. A key issue that emerges from the consultation exercise is the need to prioritise. Respondents challenged Ofgem to prioritise our objectives, workstrands and resources more effectively.
- 1.4. The themes of the strategy flow from Ofgem's statutory duties, and are interlinked. We do not, therefore, believe it is possible to prioritise the themes. However, we have addressed prioritisation of our deliverables through the recent resource review, and in producing our detailed Corporate Plan. The resource review has identified organisational changes that will allow us to work more efficiently and cost-effectively.² In addition, as a result of the review the organisation is now structured more closely around the themes of the strategy. The draft Corporate Plan, on which we are consulting, flows from this new structure and gives an indication of priorities, on which we welcome further feedback.
- 1.5. One respondent identified compliance as a missing theme, and suggested that Ofgem's Strategy should give more detail on how we will use enforcement

¹ There is a summary of these responses on the corporate planning section of Ofgem's website

action to protect consumers and, by taking action, promote confidence in the market. Ofgem takes very seriously its task of enforcing compliance with companies' licence conditions, and with statutory provisions (including the Competition Act 1998). We will make vigorous use of our enforcement powers where necessary. Furthermore, as a result of the resource review, enforcement and Competition Act investigations are brought into the new Corporate Affairs Division, where there will be a renewed emphasis on these activities.

Creating and sustaining competition

- 1.6. The key issues that emerged from the responses to this theme were the extent of regulation and market monitoring in the retail and wholesale markets, and concerns over the structure of the markets.
- 1.7. Ofgem has also been urged not to pursue competition for its own sake, nor to seek fundamental reform of existing market arrangements in the absence of clear benefits. Ofgem pursues competition only where it is the appropriate mechanism for protecting customers' interests. Going forward, all of Ofgem's important policy proposals will be supported by a regulatory impact assessment (RIA) that will weigh costs and benefits where this is practical, and will provide an opportunity for interested parties to give their views on the assessment of costs and benefits, and hence the merits of our proposals.
- 1.8. Several respondents challenge Ofgem to withdraw from regulating and monitoring markets where competition is established, or the industry is capable of self-regulation. In relation to wholesale markets, we continue to believe that ongoing market monitoring is necessary in order to be able to detect market manipulation. As a result of the resource review, we have brought together retail and wholesale market monitoring activities within the new Markets Division. We believe that this will allow us to work more cost-effectively in this area.
- 1.9. In relation to the retail markets, some suggested that Ofgem should withdraw further from regulation, for example by removing unnecessary licence conditions. Other respondents (customers and customer groups) suggested that regulation of certain areas is still required to protect consumers' interests

(particularly vulnerable consumers) and that Ofgem's role in monitoring competition and improving customer confidence is very important.

- 1.10. Ofgem has a good record on withdrawing from regulation (for example on supply price controls). We continue to believe that market monitoring is important because retail markets are not yet mature and wholesale energy markets have special characteristics that justify the presence of an expert regulator/competition authority with detailed knowledge and experience of the sector. We have committed, as one of our deliverables, to initiating a review of the existing supply licence obligations against the Better Regulation principles. A particular focus of the review will be ensuring that the conditions are targeted and effective and do not create barriers to entry. Going forward, Ofgem will continue to strive to identify possible improvements in the way the market works and ensure that monitoring is effective and targeted.
- 1.11. Some respondents have concerns over the structure of the market, including recent consolidation and vertical integration. Ofgem will continue to assess structural developments in terms of the impacts they have on customers and competition, and assess merger and acquisition proposals in gas and electricity markets in order to advise the relevant competition authorities. It is essential that the structure of the markets we regulate continues to be compatible with effective competition. In a dynamic market, this is an ongoing task.
- 1.12. It is suggested that Ofgem should withdraw from the governance of the various industry codes and charging methodologies, especially for minor changes. We firmly believe Ofgem's role in the governance of industry codes to be essential if changes are to promote competition and protect consumers' interests. The lesson of the Electricity Pool post privatisation was that self-governance, with a very limited role for the regulator, did not deliver effective outcomes in terms of promoting competition or allowing the industry rules to evolve with the market. We will be working with the DTI to make the appeals process set out in the Energy Bill a proportionate addition to the industry governance arrangements, and ensure that it addresses some of the concerns expressed by the industry about our role.

Regulating network monopolies

- 1.13. Responses to this section focused mainly on incentives to invest, both in distribution and transmission networks. Ofgem's approach to providing companies with commercial incentives for new investment in electricity (and gas) transmission is challenged on the grounds that 'deep System Operator' incentives are too complex, and that we have not demonstrated benefits over the simpler approach taken for electricity distribution networks and distributed generation. Ofgem is currently working on a framework for additional transmission investment required to meet forecast increases in renewable generation over the next two to three years. We consider this to be a priority issue, and recognise that a balance needs to be struck between protecting customers' interests by ensuring that they do not end up paying for transmission assets that are built which are not used, and risking inefficient delay in investment. Ofgem favours a consistent approach across the networks, and simple solutions where these will be effective. Our RIA process will draw out these tradeoffs and provide the industry and customers with an opportunity to debate further these trade-offs and provide their views on whether we have struck the appropriate balance..
- 1.14. We welcome the support for our commitment to regulate outputs rather than inputs (wherever practical), such as the proposed new quality of service scheme in gas distribution.

Helping protect security of Britain's energy supplies

- 1.15. Overall there was wide support for security of supply being central to Ofgem's Strategy, but there was disagreement on whether market signals alone can be relied upon to deliver investment in security of supply (particularly over the longer term), and clarification of NGC's system operator role was also requested. Ofgem has tried to address the latter concern by setting out more clearly our interpretation of NGC's role in a recent publication on NGC's SO incentives³.
- 1.16. Ofgem believes that a combination of competitive wholesale and retail energy markets and appropriate incentive-based regulation on network operators is the

³ NGC System Operator incentive scheme from April 2004—proposals and statutory licence consultation ,
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best way to deliver security of supply cost effectively. We are not, however, complacent and will continue to monitor the markets response to emerging issues. We will also continue actively to communicate our views on security of supply to ensure that all interested parties have an understanding of what we are trying to achieve, and have the opportunity to contribute to an open debate by presenting evidence and argument challenging Ofgem's policy. Ofgem works with DTI on the Joint Energy Security of Supply (JESS) working group which publishes forward looking security of supply indicators every six months. We also report retrospectively twice a year on out-turn levels of security of supply, relevant events and lessons learned.

- 1.17. Respondents emphasised the importance of the demand side in contributing to security of supply. The demand side already plays a role—in electricity some demand customers lower their consumption during periods of peak demand to avoid transmission charges. In gas many larger customers are on 'interruptible' contracts. There is clearly the potential for the demand side to make a more significant contribution, and we will continue our work with the Demand Side Working Group to ensure that there are no barriers to further participation by demand customers in energy markets.

A leading voice in Europe

- 1.18. There was wide support for Ofgem's identification of European issues as requiring a high priority. However, some respondents also encouraged Ofgem to make sure that this activity is bounded and focussed on our duty to protect the interests of consumers in Great Britain.
- 1.19. Ofgem agrees that the focus of our activity in Europe should be on those issues relevant to the interests of consumers in Great Britain. However, increased interconnection and import of energy supplies from continental Europe mean that key Member States' implementation of European legislation and regulation will be of direct relevance. Increased interconnection will require effective access arrangements for gas and electricity across Europe. Ofgem does not, however, propose to extend its market monitoring activities across the European Union. Ofgem believes that liberalisation across Europe must not be undermined

by industry structure—we will work with the relevant competition authorities and DTI on this.

- 1.20. A closely co-ordinated Ofgem and DTI approach to these issues will be required.

Helping protect the environment

- 1.21. We are pleased to see general support for our approach to environmental issues. We are challenged to place more emphasis on energy efficiency, and on communicating its value to customers.

- 1.22. Ofgem has a statutory responsibility to have regard to the social and environmental guidance from the Secretary of State, and we will take an active interest in advising Government on the design of the EEC commitment (although the decision on this is for Government, as it is for all environmental matters with significant financial implications for consumers). The likely upward pressure on energy prices (from new environmental legislation covering emissions of CO₂ and SO₂) make the case for investment in energy efficiency stronger. We believe that community-based resources such as the Energy Efficiency Advice Centres are best placed to advise individual customers on the merits of such investments, so our role is to work with those who provide advice to customers on the most effective options.

- 1.23. Following announcement of the pilot energy services trial, in which suppliers are permitted to offer domestic consumers energy service packages linked to longer supply contracts than are possible under the normal 28-day rule arrangements, we will be monitoring the effectiveness of the pilots in delivering energy service benefits, and at maintaining consumer protection.

Helping tackle fuel poverty

- 1.24. There was general support for the importance of Ofgem's role in tackling fuel poverty. Respondents challenged Ofgem to say and do more on debt and disconnections, and to encourage tariffs designed specifically to help vulnerable groups. There was disagreement from respondents on the role that energy efficiency measures have in reducing fuel poverty.

- 1.25. Ofgem encourages suppliers to use disconnection as a last resort only for customers who will not pay rather than for those who cannot pay. We believe

that, in a competitive retail market, suppliers must be free to develop tariffs that they believe will be attractive to customers, including vulnerable customers. A number of suppliers have developed such tariffs and there is continuing innovation from suppliers.

- 1.26. We will continue to work with suppliers to improve their handling of customers in debt and to help customers to avoid getting into debt.

Improving Ofgem's efficiency and effectiveness

- 1.27. Several of the companies that we regulate believe that Ofgem's costs are too high and that Ofgem remains too busy as a regulator. We have responded to these concerns through the resource review, maintaining our commitment to a six percent budget cut for 2004–5 compared to 2003–4 (eight percent in real terms), and committing to an RPI-X budget cap from April 2005. The budget cap will be set following a thorough review of Ofgem's cost base, to be carried out by the Audit Committee of the Gas and Electricity Markets Authority.
- 1.28. It is not possible to prioritise the themes of the Strategy, because they are interlinked and derive from our statutory duties. However, we have taken steps to prioritise the detailed deliverables which flow from the Strategy. These are described in the draft Corporate Plan.
- 1.29. Respondents provided some positive feedback on Ofgem's commitment to regulatory impact assessments (RIAs) and the engagement of industry and customers in the RIA process. Some respondents challenged Ofgem on process and transparency. In particular, there was concern over the way in which the Authority/Ofgem arrives at policy decisions.
- 1.30. The creation of the new Corporate Affairs Division within Ofgem will allow us to maintain a proper focus on our internal decision-making processes, including the important formal decisions taken by the Authority. Under the Sustainable Energy Act 2003, we are also required to produce impact assessments, including for significant modification proposals under the various industry codes. This should increase transparency in our decision making processes.
- 1.31. Ofgem has always sought to work in an open and transparent fashion, with full consultation. Nevertheless we recognise that our consultation process could be

improved, and we will seek to improve the quality and targeting of our consultations, and to make consultation papers more concise and focused. Following an internal review, we will publish the guidelines that we will follow on preparing impact assessments in future.