

Ofgem's Three Year Strategy
Comments from the Association of Electricity Producers

05 October 2004

Introduction: The Association welcomes the opportunity to comment on Ofgem's three year strategy. The Association of Electricity Producers (AEP) is the UK trade association representing electricity generators. It has some 100 members ranging from small firms to large, well-known PLCs. Between them they embrace nearly every generating technology used in the UK. Many member companies have interests in the production and development of renewable energy where the government has set ambitious targets for development over the next decades.

General Comments:

We welcome Ofgem's recognition of a changing regulatory environment and the response to review your organisation and functions, and to place greater emphasis on costs. We believe the increasing liberalisation of the European energy sector is an area where Ofgem can make a major contribution. The UK energy market is now maturing and Ofgem is in a position to disengage from the day-to-day interventions that have been a feature of its activities to date. The tools at Ofgem's disposal should enable it to prioritise and ration activity to those areas in which obvious and substantial gains can be made. We anticipate these will be in the policy area.

1. Cost Control

In a benchmarking study for the European Council at Stockholm (Brussels, 3.12.2001, SEC (2001) 1957) the UK performed very well against the EC criteria for liberalization of the both the electricity and gas markets (see tables 1, 3, Executive Summary). Unfortunately, it also had the most expensive regulator by far, its reported 2001 budget of €103m being greater than the combined budgets of the 12 other countries that reported a budget (Appendix 4). Additionally, the reported staffing level of 340 was nearly twice the size of the next nearest (Sweden 162 staff). Even allowing for the fact that 2001-2's budget may have been large because of one-off NETA costs, the proposed Ofgem budgets for the next 3 years (~€58m, 58m, 54m) were each nearly three times the next nearest 2001 budget (Sweden, €20.5m). It should be remembered that at this time Ofgem was operating in the most liberalised energy market in Europe. This is the context within which any commitment to RPI-X management of budgets needs to be considered. The Association suggests there is scope for a zero-based review of Ofgem budgets, not just a marginal shaving of resource.

If Ofgem is committed to a value for money approach, it might be useful to commission an update of the 2001 report. Obviously such an update should not be undertaken, unless Ofgem intend to act on the results.

It is always difficult to rank projects in the regulatory area and hence ration resource between them. However, the requirement for Ofgem to now undertake impact assessments on major changes should provide a platform on which diverse projects can be consistently and systematically assessed. This should lead to a more focused use of regulatory resources. It will also allow Ofgem to make defensible rationing decisions about its resource, in both an absolute and relative way.

2. Balance of Activities

Using the 2004/5 budget as a base, it is very noticeable that Creating and Sustaining Competition is by far the largest budget. Obviously, a large chunk of that is BETTA and the effort must now be to ensure timely and cost efficient implementation of the revised trading arrangements. Beyond that however, it seems inappropriate to us that the budget

concerned with competitive activity should be greater than the budget applied to regulating monopolies, surely the natural territory for a regulator. The Association has made comments similar to this in every year since the creation of Ofgem and makes no apology for repeating them. We believe that within Ofgem there is an expectation that regulating competition demands a large budget and we fear there is no serious challenge to this assumption.

Two other areas that are neither market monitoring, nor monopoly regulation arise from obligations put upon Ofgem. The Association suggests that in the areas of 'Protecting the Environment' and 'Tackling Fuel poverty' Ofgem could usefully look at diminishing their involvement and applying the following criteria to such a review:

- Must Ofgem be involved at all? Should another agency do this, or should it be left to the market?
- Must Ofgem be involved in practical sense? Is anything more than a policy framework required? Should Ofgem do anything more than monitor and report to government?
- Does Ofgem need to do the job itself? If Ofgem needs to be practically involved, would it be more cost effective to outsource the activity?

Ofgem is playing a leading role in European energy liberalisation. The Association applauds this. The duration and variety of experience of market liberalisation in Great Britain is probably unequalled. Also Ofgem's commitment to market-based solutions wherever appropriate places it philosophically in the progressive wing in Europe. We believe that Ofgem's major contribution in liberalisation will help Europe as a whole and will also be to the greater benefit of Britain. We agree with the government's policy of supporting liberalised market solutions as the basis of ensuring our own security of supply in the longer term. We welcome Ofgem's engagement with the UK electricity industry on this issue and look forward to further discussions.

3. Policy vs. Intervention in market

After the implementation of BETTA and the Gas Distribution Network sales, we look forward to Ofgem reducing its interventions in the electricity and gas markets. It should be a sign of a maturing market, that Ofgem consider a change of emphasis towards market monitoring and policy frameworks and away from decisions required in operational timescales.

The Energy Act 2004 also places an obligation on Ofgem to have regard to the principles of good regulation including the requirements for action to be 'targeted only at cases where action is needed' and for it to be 'proportionate'. The use of RIAs mentioned above should help Ofgem to limit its interventions to only those that can demonstrably comply with these principles.

4. Process Issues

Appeals & decision Timescales: DTI is about to consult on the details of the appeals provisions for Ofgem decisions. Ofgem are now obliged to conduct impact assessments on major changes. These two need to be factored into the timescales for modification decision. Nevertheless, one of the principles of the DTI proposals was that a short duration appeal process would not enhance regulatory uncertainty. The Association is concerned that in the past Ofgem has refused to accept the concept of operational targets for decision making. We believe that the consideration of the appeals process gives Ofgem a golden opportunity to demonstrate its commitment to timely decision making. This would reduce regulatory uncertainty for industry participants.

Gas Distribution Network Sales: This is a major project with huge commercial consequences for the industry. The Association, in common with other trade bodies has contributed much resource to support the project process and ensure its success. It is a disappointment that the results of this process have tended to be driven by an Ofgem view of the world, with little emphasis on analysing and understanding the views of others. The requirement for reform of exit arrangements as a 'gateway issue' is a particular example of this.