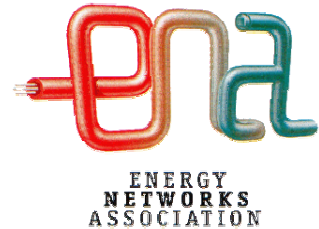


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4 October 2004



Dear Andy

## **Re: Ofgem's Three Year Strategy 2005-8**

The Energy Networks Association (ENA) is the trade body that represents gas and electricity transmission and distribution companies in the UK. We are pleased to contribute to your three year strategy for 2005-8 on behalf of the Energy Networks Sector.

This letter sets out ENA members' views on the appropriate priorities for Ofgem in the light of the challenges it faces. The ENA recognises Ofgem's continuing commitment to consult widely on its future work programme before finalising its strategic plan, which once finalised should explain your priorities and provide advance notice of proposed structural changes.

The ENA believes there is now a need to narrow down the range of tasks over the next year or so in order to give greater focus to the priority issues. In our view Ofgem should seek to concentrate on issues which have the greatest impact on customers and those that impose significant costs to licence holders. We appreciate that Ofgem is faced with a range of Energy Policy issues, including renewable energy and energy efficiency which are essential for future expansion and energy efficiency is a critical part of tackling fuel poverty. However it is not our intention to focus on such issues here, therefore please find below our views which specifically address the Energy Network Sector's concerns in respect of the questions set out in your letter.

### **1. The key challenges you consider the industry faces in the short to medium term (for example, structural, social, environmental or technological)**

The ENA believes a factor that should remain at the forefront of Ofgem's mind is to ensure consistency between Government and Ofgem initiatives. The ENA believes that Ofgem has an influential role in advising Government on the practical implications of policy proposals, as well as in developing the more specific incentives that should ensure delivery of these objectives.

The key challenge facing Ofgem in the short term is the implementation of the DPCR4. Ofgem should also be mindful of the lessons learnt in conducting the current DPCR4 when looking at the future transmission (both gas and electricity) reviews, and the restructuring of the gas market to facilitate the sale of LDZ assets by NGT. Beyond that members support a review of the process,

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methodology and the outcome in order to assist in deciding the best way forward for DPCR5. There is a need to revisit the traditional approach to network utility regulation in order to accommodate for recent developments and in particular the Government's objectives for renewable energy, energy efficiency and security of supply. It is important therefore to think about how we might manage this process of adapting the regulatory framework whilst ensuring the network companies continue to provide a high level of service to meet customer expectations.

Another challenge is the need to develop an integrated approach to network investment, security of supply and standards of performance. The asset bases that the DNOs are operating are now entering a period of asset renewal, and thus investment has started to steadily increase. This will be a long term process, which needs to be managed appropriately to help ensure improved performance in terms of reliability, quality of supply and resilience. In helping to ensure markets deliver security of supply, effective incentives on market participants need to be put in place to meet energy demands reliably and to bring forward new capacity in a timely way.

An additional point to make here is now that Ofgem has a duty to report to Parliament under the Energy Act on the capacity of the network, it would be helpful if Ofgem set out how they intend to ensure it is compliant.

A further challenge is its role within Europe, members recognise the significance of new European legislation and the important role Ofgem can play in influencing developments and policies. In particular, Ofgem's role in seeking to minimise any unnecessary burden on the energy industries of the UK arising from new European legislation. Ofgem can also play a part in lobbying at the European level to ensure markets are opened to competition. The ENA would welcome working together with Ofgem, in influencing policy within Europe and developing initiatives.

## **2. The action you consider the Authority should take to respond to these challenges**

While the challenges mentioned above are broadly addressed in Ofgem's existing corporate strategy there is a need to concentrate on key priorities over the next couple of years. ENA Members therefore support Ofgem's further withdrawal from regulation in some areas, for example, by removing certain licence conditions. This would help Ofgem to have a more focussed approach on the key priorities we have highlighted below as it would allow resources currently being spent on less important issues to be better utilised.

We welcome Ofgem's use of Regulatory Impact Assessments (RIAs) for all major areas of work. However the current approach for RIA's fails to take into account the real impact regulatory projects can have on the industry. Where regulation imposes significant costs, it is crucial that a cost benefit analysis is carried out. Therefore some changes to the way they are compiled needs to be considered. For instance, the estimated costs of parties should receive more attention; there is a tendency at present for these to be dealt with in very general terms, and sometimes with little or no quantification.

Another more general point to make here is one of process; further improvements could be made to the consultation and policy making process. ENA members believe it would be beneficial if there were greater prioritisation of new policy initiatives given the range of new incentive and other arrangements facing network companies as well as being given longer time for consultation responses. As a guide, Ofgem could consider the Cabinet Office guidelines, which state that 12 weeks should be the normal practice for consultation periods.

**3. The priority of areas of work that you think we should tackle, in response to the challenges you identify.**

The ENA believes that the priorities for Ofgem are as set out below:

- Concentration on issues which have the greatest impact on customers and impose significant costs to licence holders.
- Full implementation of DCPR4, including implementation of the separate metering price control and associated licence modifications.
- Review of the basis of regulation, taking into account the ageing condition of the network, to help assist in deciding the best way forward for DPCR5.
- The development of an integrated approach to network investment, security of supply and standards of performance.
- The further withdrawal from areas where regulation is no longer needed and a review of Ofgem priorities.

I hope you find our comments helpful. We would look forward to the draft Corporate Strategy 2005-08.

Yours sincerely

Andy Phelps  
Head of Regulation