

Mr Andy MacFaul
Head of Government Affairs
Ofgem
9 Millbank
London
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1 October, 2004

Dear Mr MacFaul,

Ofgem's three year strategy 2005-8

RWE npower welcomes the opportunity to contribute to the development of Ofgem's three-year strategy.

We believe that Ofgem has responded to the changing regulatory environment with the organisational review it has undertaken and the focus it has placed on costs. However, we have a number of further suggestions that could be appropriate for the evolution of the industry's regulation within the timescales of this strategy.

We appreciate that there remain a number of sizable issues that need to be resolved. We should be happy to participate in identifying these and contributing to an agreed plan of action for taking this forward. The maturing of the gas and electricity markets means that it may now be timely for the Authority to consider the nature of its involvement in the day to day management of these markets, and how it might best fulfil its statutory objectives by focussing on public policy issues both within the UK and Europe.

In the UK the experience that Ofgem has gained from the development of the market should enable it to be influential in converting Government policy into pragmatic initiatives that would best serve the interests of consumers. This should be even more the case in Europe where the experience gained in the UK should be of particular relevance to the liberalisation of the European market.

We are not advocating that Ofgem withdraw completely from their involvement in the day to day functioning of the UK markets, but that there is a change of emphasis with market participants assuming more responsibility for decision making in operational timescales. We believe this to be a natural evolution of a maturing market.

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Such a shift of emphasis would suggest the following consequences for the themes in the three-year strategy.

Creating and sustaining competition

Competition has now developed in both the electricity and gas wholesale and retail markets to such an extent that market participants should be encouraged to take on more responsibility for the development of the arrangements. Ofgem's role should become more of an arbiter than seeking to involve itself in the mechanics of the market processes. This in turn implies making the Panels that govern the various Codes more autonomous in their operation albeit with rights of appeal by industry Parties to the Authority. The development of voluntary codes of practice within the retail sector of the industry indicates the general affinity in the industry for such an approach. An example of Ofgem taking a more strategic approach to the functioning of the market is the creation of a working group looking at gas and electricity cash-out prices.

Regulating network monopolies

Here too we would suggest that Ofgem should consider providing the strategic direction needed to cope with the changing circumstances faced by the network owners rather than seeking to manage the detailed issues that emerge. Often Users are best placed to develop solutions to particular issues directly with network owners especially where technical matters are involved. However, Ofgem's role as arbiter in these circumstances would be crucial given the monopoly nature of the network businesses.

Helping protect security of Britain's energy supplies

We continue to support market solutions as the most effective approach for delivering security for energy supplies. Generally we are pleased to see that Ofgem actively supports this standpoint also. Notwithstanding this we remain concerned at the freedom that NGT has in its participation in forward markets and the potential such freedom has for misinterpretation by the rest of the market. The electricity market still has to find an appropriate framework for the provision of reserve that can also deliver the requisite market signals.

A leading voice in Europe

We are pleased to see that Ofgem is committed to taking a greater strategic involvement in European issues. Ofgem's experience in the evolution of the GB market will enable it to provide an authoritative view on many of the issues currently being addressed by European regulators. Such involvement is also essential to ensure that the progress that has been made in establishing an effective market in GB is not undermined by reactionary responses elsewhere in Europe. In establishing a presence in the European evolution we are also appreciative of the involvement of Ofgem, and the DTI, in consensus seeking groups such as that hosted by the AEP.

Helping protect the environment

One of the most significant influences on the GB market will be the impact of European and governmental environmental policy. We believe that Ofgem can best serve the interests of consumers by engaging fully in the process of translating policy into practical market based solutions. As an example of where Ofgem could do more, the Government has decided that the electricity sector will bear the brunt of carbon reductions to be delivered under the 1st phase of the EU emissions trading scheme. The draft allocation proposals have potentially significant implications for the electricity market and security of supply. It is this sort of area that we believe Ofgem should get more involved. Often Ofgem is left with the role of administering solutions (such as ROCs), which at times conflicts with finding the most efficient approach. We would hope that Ofgem can transfer the administration of relevant schemes to agencies thus allowing it to concentrate its resources on the policy issues and promotion of market based solutions.

Helping tackle fuel poverty

Rising fuel costs, coupled with the apparent exhaustion of the bulk of the efficiency gains that can be made from the transportation of energy, imply higher electricity and gas prices in the medium term. This will accentuate the pressures on government social policies, and Ofgem's role in these. Such support as is needed for the disadvantaged groups in society should not be at the expenses of prejudicing the market arrangements. RWE Npower is supportive of the Energy Efficiency Commitment. However, we are disappointed to see the continuing reliance on improved insulation of buildings as the key manner in which Suppliers deliver this commitment. There is a need to introduce more innovation into the DEFRA scheme if the advances that are needed are to be achieved.

Improving Ofgem's efficiency and effectiveness

Ofgem has made progress with its organisational review and the adoption of an RPI-X formula will provide an added incentive for controlling costs. The refocusing of activities we have described above should assist in ensuring Ofgem continues to develop as an efficient and effective organisation.

Yours sincerely,

Original letter signed

Andrew Duff
CEO RWE npower