

RESPONSES TO THE CORPORATE STRATEGY INITIAL CONSULTATION LETTER

Sir John Mogg wrote on 5 August 2004 seeking views on the key challenges facing the industry in the short to medium term; the action required from Ofgem and the priorities on which Ofgem should focus. Ofgem received responses from energy sector companies¹, trade associations², fuel poverty groups³, an environmental group⁴ and other Government departments⁵. The main comments are grouped under the seven themes and summarised below.

Creating and Sustaining Competition

Several respondents argued that competition has matured and the existing regulatory framework is therefore overly prescriptive. They suggested that Ofgem should identify opportunities to withdraw from directly regulating competitive markets, and place greater reliance on industry self-regulation. One respondent suggested that Ofgem might wish to produce a more regular update on the state of retail competition. Some respondents stated that Ofgem should review the scope for removing supply licence conditions; one of these also called for a review of all reporting of information to Ofgem. Another respondent stated that if Ofgem withdraws from direct regulation it will be necessary to monitor companies to ensure their ongoing commitment to health and safety.

One respondent noted that additional regulatory requirements in relation to vulnerable customers might be needed for a longer period. Others said that a key priority for Ofgem is to ensure that suppliers provide clearer information on tariffs (including those for vulnerable customers) and on the source of the energy supplied to customers.

Respondents said that Ofgem should devote resources to investigating wholesale gas prices. Some said that Ofgem should continue to encourage more transparency in upstream markets and publication of more data, as this would increase market confidence and efficiency. Two parties said that the regulatory framework should be reviewed to encourage higher levels of investment in sustainable energy sources.

One respondent called for reviews of the impact of vertical integration on competition, and of whether generators have sufficient incentive to provide adequate reserve plant. Another noted that the market still has to find an appropriate framework for the provision of reserve that also delivered the necessary market signals.

Regulating Network Monopolies

Respondents wanted Ofgem to review the basis of network regulation taking account of the ageing network ahead of DPCR5. Respondents also wanted Ofgem to develop an integrated approach to network investment, security of supply and standards of performance, with the aim of ensuring that market participants have effective incentives to bring forward new capacity in a timely way.

¹ British Energy, BP, Centrica, EDF Energy, E.ON UK, National Grid Transco, RWE npower, Scottish Coal, Scottish Power, Scottish and Southern, Shell Gas Direct and United Utilities.

² Association of Electricity Producers, the Energy Networks Association, the Gas Forum, the UK Offshore Operators' Association, and Water UK.

³ Energy Action Scotland and National Energy Action.

⁴ Greenpeace.

⁵ DTI, DEFRA (confidential), the Environment Agency and HSE sent substantive responses. ORR and the Scottish Environment Protection Agency responded but had no comments.

It was suggested that Ofgem should work with DNOs to establish robust output measures before DPCR5, and develop a longer term strategy for networks on storm resilience, quality of supply and distributed generation. The same party stated that Ofgem should ensure that independently built connections and embedded networks are subject to the same quality of service requirements as DNOs. One respondent suggested an ongoing evaluation of the rewards and penalties applied to planned and unplanned interruptions to find the correct balance between encouraging improvements to the quality of service with the routine maintenance required for network reinforcement.

It was also suggested that Ofgem take a strategic role in relation to networks where users were often best placed to develop solutions directly with network operators, recognising that Ofgem would have to act as arbiter given the network businesses' monopoly characteristics. One respondent said that Ofgem should not always see its main task as making more areas of natural monopoly contestable; robust analysis was needed and a clear demonstration that the benefits of liberalisation outweigh the costs in each case.

One respondent stated that Ofgem should ensure proportionate and non-discriminatory transmission charging under BETTA. This respondent stated that the changes following the implementation of BETTA should be given time to settle down before any new initiatives are introduced. Other parties suggested that Ofgem should continue to encourage locational charging under BETTA, should review BETTA one year after Go-Live, and should consider the compatibility of BETTA with continental models.

Some respondents made the point that Ofgem should focus on what is necessary to facilitate gas distribution network sales and not link the sales to other projects such as the reform of exit arrangements.

Security of Supply

Many responses highlighted security of supply of supply as one of the main challenges facing both the gas and electricity industries, especially given the switch to becoming a net importer of gas. Respondents noted that increasing levels of capital investment will be required to replace ageing assets and to accommodate renewable generation and imported gas. These respondents called for Ofgem to ensure that the regulatory framework provides incentives for companies to invest in networks. One respondent recommended that Ofgem monitor the impact of embedded generation on the maintenance of grid stability and security of supply. This respondent also considered that gas quality will present challenges as the UK imports more gas. One respondent stated that Ofgem proposals should be assessed as to whether they improve security of supply.

Respondents stated that competition was the best means of delivering security of supply. One respondent saw the review of cash-out prices as a priority. One respondent stated that the lessons learnt from the DPCR should be incorporated into the forthcoming gas network price review and DPCR5. This respondent felt that Ofgem should monitor network resilience on a regular basis.

Some respondents stated that greater transparency in offshore gas markets was required to help address security of supply concerns. One respondent contrasted gas with electricity, where expected production levels and near real-time actual production levels were disclosed to all market participants. This respondent called for the Financial Services Authority to be given powers to monitor internet trading platforms in real time, as is the case with the International Petroleum Exchange.

Europe

Many respondents stated that Ofgem had a vital role to promote the liberalisation of European markets. They wanted Ofgem to work with the European Commission and energy regulators to ensure full and effective liberalisation of the European energy markets and in shaping the regulatory agenda going forward. Some respondents hoped that Ofgem would argue for non-interventionist approaches to security of supply, and encourage the Commission to avoid seeking to direct investment in generation and networks in prescriptive ways. One respondent agreed that European Directives should be rigorously implemented but considered that it was DTI's role to input at the European level, and stated that Ofgem should not be advocating proposals in Europe contrary to the DTI's position.

Environmental Policy

A number of respondents noted that the Government's environmental targets increased costs for an industry under pressure not to raise prices unreasonably to customers. Some considered that Ofgem should contribute more openly to the debate on the cost effectiveness of different environmental policy options, so that the Government does not set disproportionately high environmental targets and costs for the energy sector.

Two respondents stated that Ofgem should consider outsourcing the administration of Government environmental schemes; they believed that this would free Ofgem to analyse whether existing policies are cost-effective, and to promote market-based alternatives. One respondent suggested that Ofgem should focus on core tasks and not undertake administrative work, for instance in relation to ROC/CCL which could be carried out by industry bodies like the Non-Fossil Fuel Purchasing Agency.

One respondent stated that Ofgem should give greater prominence to the 60 per cent carbon reduction target, and that Ofgem's approach to network development was insufficient to the task. The respondent wanted Ofgem and NGT to develop a common vision of how the network should be developed. The respondent also stated that Ofgem should take account of climate change costs falling outside its remit, and recognise the costs of inaction (eg on Scottish grid investment). Another respondent stated that co-firing guidance should enable the co-firing industry to contribute to the Government's renewable targets. The respondent felt that Ofgem should allow the use of off-site combi fuel because of its beneficial effect on the environment and security of supply.

Fuel Poverty

Some respondents thought that tackling fuel poverty should be one of Ofgem's main priorities in an era of rising fuel prices. One respondent believed that Ofgem should pursue new energy efficiency measures for homes currently classed as hard to heat, and urged Ofgem to continue working with NGOs and energy efficiency professionals to tackle fuel poverty. This respondent would also like Ofgem to ensure that suppliers provide clearer information on tariffs and services such as the Priority Service Register.

A different respondent stated that Ofgem should put more effort into ensuring that low income customers switch company and/or payment method, and should do more to build on the Factor Four project. This respondent wanted Ofgem to establish a ceiling above which an indebted consumer is not liable for a proportion of the debt, set a progressively declining target for the number of consumers in debt and the arrears owed, and extend the debt assignment procedure to all indebted customers regardless of payment method.

This respondent also called on Ofgem to be more vigorous in pursuing energy efficiency options, for example by assessing the social impact of EEC and issuing guidance to suppliers on how they might better use existing information about consumption and debt to target EEC better to those in most need. One respondent believed that Ofgem should ensure that consumers as well as shareholders benefit from the DN sales, and that extending the gas network would be an appropriate way of doing so.

Improving Ofgem's Efficiency and Effectiveness

Some respondents were concerned about Ofgem's cost effectiveness. Most of these respondents welcomed Ofgem's intention to apply to itself a RPI-X cost control mechanism from April 2005. One respondent suggested that Ofgem was too large given that there are competitive supply markets and well established approaches to regulating natural monopolies. Others noted that Ofgem's costs should reduce when the BETTA and DPCR projects are finished. Some respondents wanted Ofgem to focus on a smaller number of work areas. One respondent stated that Ofgem should prioritise its objectives and address how it will reconcile conflicting priorities.

It was suggested that the quality of industry input into Ofgem consultations might be suffering because industry resources were overstretched. Some respondents felt there was a tendency for overlapping requests for data and consultation, noting that many companies do not have the resources to attend the work groups; they argued that more effort should be made to co-ordinate work areas. One party stated that Ofgem should set up quarterly events for industry to give overviews of the progress in various areas of work. One respondent cautioned that work groups should not be substitutes for formal consultation. Another respondent wanted Ofgem to avoid overly technical consultations as they deterred the wider public from getting involved. One respondent welcomed Ofgem's move to six week consultation periods, but suggested that eight weeks would be more appropriate. Two other respondents considered that Ofgem should move towards twelve-week consultation periods.

Respondents welcomed Impact Assessments (IAs) but noted that there was room to develop them further, especially in relation to assessing the implementation costs faced by companies. One respondent suggested that Ofgem introduce IAs at the strategic level as part of the planning process. Another suggested that IAs should give parties a clearer understanding on how policy choices had been made.

One respondent suggested that Ofgem could be more efficient, for instance in relation to certain code modification decisions, and would like Ofgem to produce reports on how long it takes over code modifications decisions.

One respondent wanted more transparency of Authority proceedings, such as publishing the dates of meetings, agendas, attendance and a non-confidential summary of minutes.