

Ofgem proposed Corporate Strategy and Plan 2005-2010  
Comments from the Association of Electricity Producers

04 March 2005

Introduction: The Association welcomes the opportunity to comment on Ofgem's Corporate Strategy and Plan 2005-2010. 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 its organisation and functions, and to place greater emphasis on costs. We also note that the proposed Strategy and Plan does take account of at least some of the responses to the initial consultation. Ofgem's commitment to transparency is commendable and we make some suggestions where this can be enhanced. The commitment to an 'RPI-X' discipline is useful. Nevertheless, Ofgem remains an extremely expensive regulator when compared with other EU members.

Ofgem's web site records an output of 290 documents in the year up to 23/12/2004. It is difficult to accept that, in the interest of regulating monopolies and supporting competition, a mature liberalised industry needs nearly one document per day, six days per week, for a year. It is doubtful whether industry participants can respond effectively to such a flood. This therefore begs the question of the purpose of consultation. We urge Ofgem to consider both the scope of its activities and the consultation process with a view to concentrating on those areas of activity where it can show real benefit. We also suggest that the current process involves needless duplication and repetition that could be substantially reduced.

Whilst we believe the increasing liberalisation of the European energy sector is an area where Ofgem can make a major contribution, we also suggest that Ofgem is in a position to disengage from the day-to-day interventions that have been a feature of its activities to date. We had hoped that the tools at Ofgem's disposal such as RIA and the concurrent powers granted under the Competition Act 1998 would have enabled it to ration activity to those areas in which obvious and substantial gains can be made.

1. Cost Control The 'RPI-X' discipline that Ofgem has voluntarily submitted to is commendable. However the result of the latest available benchmarking study (Third benchmarking report on the implementation of the internal electricity and gas market, Brussels 01.03.2004) demonstrates that UK continues to have the most expensive regulator by far, with a higher staffing level than any other<sup>1</sup>. Given that Ofgem (and its predecessor) has now been operating in the most liberalised market in Europe for nearly a decade and a half, we have to question whether the Ofgem culture allows for sufficient challenge of expenditure. The Association continues to believe there is scope for a zero-based review of Ofgem budgets, not just a marginal shaving of resource.

We recognize that it is always difficult to rank projects in the regulatory area and hence ration resource between them. We also note that some important issues that need to be addressed in Regulatory Impact Assessments (RIA) are not easily

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<sup>1</sup> It is not yet clear to us how the new German regulator will allocate its resources

susceptible to quantitative cost-benefit analysis. Nevertheless, a structured process of assessment of major changes should force consistent and systematic challenge of the diverse portfolio of Ofgem candidate projects. This should lead to a more focused use of regulatory resources. It will also allow Ofgem to make resource rationing decisions in both an absolute and relative way that can be defended to its various stakeholders. The outcome of this process should not merely be to use up the available budget in a better way. It should lead to absolute decreases in budget requirements. To date, we have not seen enough evidence of this required amount of rigour.

2. Balance of Activities We note and applaud that the budget area of Creating and Sustaining Competition is now finally reduced to be on a par with Regulating Network Monopolies. We look forward to greater reductions in the competition budget as the regulator focuses on its natural territory of regulating monopolies.
3. Appeals & Decision Timescales: We anticipate that the appeals provisions will be in place for April 2005. The Association believes this gives Ofgem and the Markets Authority an opportunity to make the governance process work efficiently and enhance their own transparency. We suggest that the Authority decision process is made transparent. This could be done by making meetings public, as the Code Governance Panels are. If Ofgem does not feel confident enough to take this step, then it may be sufficient to ensure that all Authority decision papers and minutes are placed on the Ofgem web site quickly enough after the decision so that an industry party considering an appeal can have full view of the process of the decision before lodging an appeal. This would reduce regulatory uncertainty for industry participants and minimize the risk of an inappropriate appeal being launched.
4. Ofgem's Role in Europe: The Association welcomes Ofgem's increased role in the European debate and its commitment to advance the liberalisation agenda in the EU. We strongly support the objective of liberalised wholesale gas markets and non-discriminatory access to gas transmission (Para 2.17).

We also welcome to commitment to promoting better regulation concepts at EU level (Para 2.18). However, we believe that this should not just cover consumer issues. The Commission should be encouraged to implement good practice, such as regulatory impact assessment across all policy areas. This is an important means of ensuring that European legislation complements rather than hinders the development of competition (Para 6.13).

Although our contacts with Ofgem suggest otherwise, in the Corporate Strategy and Plan, it appears that Ofgem's support for liberalised electricity markets at the European level is somewhat lukewarm. Electricity liberalisation is not mentioned at all among Ofgem's priorities in Para 2.17, and the section on Strategic Goals (Paras 6.9-6.11) implies that electricity liberalisation is a second-order issue. Indeed, Para 6.11 refers to "the minimum degree of harmonisation necessary" and could be read as supporting the development of regional markets rather than the objective of a European single market.

The Association finds this a disappointing stance and would welcome from Ofgem a more positive statement of its approach to European electricity liberalisation. It is true that UK gas prices are at present more influenced by the continental market than is the case with electricity. However, consumer interests should not be viewed purely from a short term perspective. Electricity and gas markets are likely to become increasingly closely linked and it is no coincidence that those Member States which

are developing gas-fired generation, e.g. Italy and Spain, have tended to show greater enthusiasm for liberalising their gas markets than others. Power companies have been an important catalyst for change in these countries. Moreover, we think that there is a weakness of logic in arguing that priority needs to be given to one sector over the other, which more protectionist Member States are likely to exploit.

The Association recognises that regulators have an important role to play in liberalising national markets and welcomes the positive role which Ofgem intends to play in CEER and ERGEG. We would like to see the regulators' bodies focus more closely on dealing with barriers to trade, and set clear priorities and timescales for moving towards an integrated European market in electricity and gas. With this goal in mind, Ofgem should make a particular effort to ensure a convergence of approach with regulators in France, Ireland and Northern Ireland.

The Association welcomes the increased efforts being made to tackle congestion management on interconnectors, but regrets the decision to exclude network users from the EU Mini-fora (Para 6.15). Experience shows that pressure from network users has been crucial to the development of competitive markets and we have considerable doubts about the value of discussions which exclude those companies who actually trade across interconnectors. The Association is concerned that a one-sided view may emerge from such discussions and urges Ofgem and other regulators to widen participation at future Mini-fora.

5. Detailed Comments: These are referenced to the relevant paragraph numbers.

Para 2.5 We agree with Ofgem's sentiments about open and transparent decision making and suggest this needs to apply specifically to the decisions that could be appealed under the new provisions.

Para 2.13 Making 'reform' of network access a gateway issue to the sell-off of gas distribution networks was greeted with universal dismay by the industry. The implication that Ofgem is resurrecting its dogmatic pursuit of auctions for access to the electricity transmission network is an example of regulatory intervention where none is needed. It will only add to the spate of regulatory consultations that the industry already suffers, with the outcome, if imposed, of higher administrative costs, greater complexity of systems and enhanced risk. We urge Ofgem to reconsider this intended course.

Paragraph 2.24 We applaud Ofgem's decision to commission an external review of its Impact Assessments to date. We look forward to publication of a lessons learnt document.

Paragraph 3.17 Ofgem has committed to 'review ... and where appropriate move to lighter-touch regulation'. We applaud this sentiment. However, we have seen little evidence of it in practice. In the recent consultation on a proposed change to connection and use of system for distribution networks, Ofgem proposed a preferred governance structure that would be akin to that set up for the transmission network (CUSC). In considering the decision making powers of a governance panel, 'Ofgem considers it appropriate for Ofgem to make the final decisions on any change that may foreseeably have an impact on consumers'. That appears to embrace virtually anything and is quite the opposite of a 'light touch'.

If Ofgem is serious about this intent to steer towards a lighter-touch regime, we suggest, as a first step, they propose a number of areas of the Industry Governance Codes that

currently it has decisive power over and that it believes it should relinquish. It is often said by Ofgem that industry parties are free to propose changes at any point. Nevertheless, Ofgem have provided open letters and 'minded-to' statements in many areas in the past. If it were to volunteer some thoughts on this issue, it would help to convince parties that it is serious about change.

Paragraph 4.24 We remain unconvinced that NGC's transmission network reliability incentive has been demonstrated to deliver any real benefits to customers. It may increase bills by ~£9m per annum. If Ofgem is seriously considering extending this system we would expect a far more rigorous assessment of its benefits than provided to date. We would also expect an analysis which demonstrates why it is the best use of additional customer funds.

Paragraph 7.20 The Association suggests that further consideration should be given to outsourcing the administration of Government environmental programmes to an experienced organisation which has a fully computerised system. Ofgem has asserted that there are benefits of Ofgem continuing to administer government environmental programmes. If there are, they should be susceptible to cost benefit analysis. We suggest Ofgem should make such analysis public, together with a detailed analysis of other possible alternative arrangements, such as outsourcing. This analysis should include the practicality of introducing alternative arrangements, the benefits it might bring to the wider environmental markets and how it might contribute towards the Government's wider energy policies. Ofgem should invite comment on the analysis. Such an analysis would be well timed, given the Government's review of the Renewables Obligation in 2005/6. The Association would welcome further discussion on this issue

Paragraph 9.8 We note and applaud Ofgem's decision to adopt operational goals for modification decisions (Appendix 2).

Paragraph 9.9 Ofgem's commitment to working with industry to improve the quality of information in impact assessments is laudable. We look forward to working with Ofgem to ensure realistic assessments of implementation costs are included in impact assessments.

Appendix 1 Corporate Plan Deliverables 2005/06 Ofgem's detailing of deliverables by quarter for 2005-06 is helpful. Recognising that this document is a 5 year strategy, it would also be helpful, if Ofgem would include such work areas as it can for succeeding years, and an indication, say on a percentage basis, of the expected split of resources by work area. Inevitably these estimates will have greater inaccuracy as they are projected forward. Nevertheless, many of the major projects have a lifetime greater than 12 months and early indications will lead to more opportunity for industry to plan and optimise its contributions to the process.