

Tel: 020 7752 2200
Fax: 020 7752 2128

Andy MacFaul
Head of Government Affairs
Ofgem
9 Millbank
London
SW1P 3GE



Date 4 March 2005

Dear Andy

Proposed Corporate Strategy and Plan 2005-2010

Thank you for the opportunity to comment on Ofgem's proposed Corporate Strategy and Plan. In this covering letter, I provide EDF Energy's views on Ofgem's developing role over the next five years and in the attachment to this letter you will find our comments on Ofgem's plans under each of the key themes.

We agree with your identification of themes and we particularly welcome the longer timescale for the plan, since a stable and predictable regulatory framework is important to those making major investments in energy supply. At the same time priorities will inevitably change over time, perhaps through political pressures as much as from industry developments. We would suggest that regulating networks will remain Ofgem's core function for the foreseeable future. Meanwhile, Ofgem should progressively withdraw from detailed intervention in competitive wholesale and retail energy markets. Nevertheless, it seems to us that security of supply will become an increasing concern that Ofgem will need to address.

The overriding political pressure will arise from concerns about climate change. The policy framework that will be developed over time will impact directly on choices made by energy companies. We believe that Ofgem has a critical role with government in ensuring that this framework is as stable as possible so that the necessary investments to ensure security of supply are made. We agree that the market should be allowed to deliver the most efficient solutions. However, very often this is in response to market mechanisms or incentives created by Ofgem or government. Therefore, these must be carefully chosen with a view to cost effectiveness and long term stability.

In wholesale markets, the focus is increasingly on the need for investment in new sources of supply. This requires action by companies with a long term commitment to energy supply. Indeed customers will benefit from there being strong companies with a route to market. At the same time, we agree that at the wholesale level there needs to be sufficient transparency and liquidity to enable risk management choices to be made. At the retail level, customers need to be able to choose between a reasonable number of reliable suppliers on the basis of their differentiated service offerings. Ofgem's activities should be limited to ensuring sufficient transparency in wholesale markets and applying its Competition Act powers where necessary.

We believe that customers and suppliers can be relied upon to obtain new connections and metering services cost effectively without further intervention by Ofgem. Where it is in their interests they will do so competitively.

We agree that in network regulation the major challenge is incentivising investment. A good start has been made with the latest DPCR but important work remains on cost reporting and financial issues. We are pleased that Ofgem resources will continue to be devoted to issues arising out of the DPCR, to ensure that the latest settlement delivers what was intended and that the necessary groundwork is laid down for the next review.

In liberalised markets, security of energy supplies needs to be provided by market solutions. The stated intention of government not to intervene means, in our view, allowing prices to be set by supply and demand, even if that means high prices at times. We agree with that intention, since investment requires those unconstrained price signals. Nevertheless, monitoring and the publication of information also have a vital role to play. Some technologies such as renewables receive support through a market mechanism and it may be necessary to consider extending such an approach for security of supply reasons, particularly if the fuel mix becomes unbalanced over time.

We support the increasing emphasis on Europe and in particular the priority given to developing a liberalised wholesale gas market in Europe, since this may be vital to security of supply and competitive prices in Britain. In electricity, we support in particular Ofgem's work with other regulators to remove barriers to the development of regional markets as first steps leading to the creation of a single energy market.

On climate change, we support a balanced approach without undue reliance on one mechanism. In particular, it is too soon to see emissions trading as the economic panacea. With the approach taken at present, it may be unduly constraining on the power sector, leading to purchase of allowances from other countries rather than actions to reduce carbon emissions in Britain, and inevitably to higher retail prices.

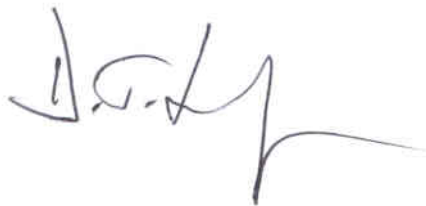
We support Ofgem's efforts to stimulate real action to alleviate fuel poverty. We have responded with our recent price freeze announcement and expect other suppliers to follow our lead. We would like to move on to discussing with Ofgem and government the creation of more enduring mechanisms that

will ensure continued assistance to vulnerable customers. Ofgem can also play a vital role in encouraging such responses and in working with government and industry to find effective ways of identifying and targeting those customers most need.

While agreeing with Ofgem's aim of reducing its expenditure in real terms, we also believe that every opportunity should be taken to make real cuts where the need for an activity has ceased rather than simply redeploying resources within the overall cap.

If you have any queries on these and the attached comments, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D. Linford', with a long horizontal flourish extending to the right.

Denis Linford
Director of Regulation

ATTACHMENT

to EDF Energy's letter dated 4 March 2005

This attachment sets out EDF Energy's views on some of the main elements of Ofgem's proposed corporate strategy and plan.

Chapter 3: Creating and sustaining competition

High gas wholesale prices: We support the ongoing investigation into gas availability during recent high-priced periods. In particular, we believe that it will be necessary to look closely both at offshore contractual arrangements and at the commercial and operational behaviour of companies in Europe with respect to storage and inter-connector flows.

Offshore data availability: We support Ofgem's recognition that wholesale markets work best when participants have access to all the relevant data. To deliver transparency and equal access, the existing temporary derogation from Transco's information licence condition should be removed and market participants should be able to obtain all relevant data through the Network Code modification process.

Governance: We are encouraged that Ofgem wants to move to lighter-touch regulation of the industry codes where appropriate. To provide confidence to market participants that this will happen, Ofgem should set out those areas where it intends to review its level of involvement and a timetable for such a review. Ofgem should also review the efficiency of arrangements where single issues are subject to multi-code governance (for example, the governance of electricity cash-out prices through the Balancing and Settlement Code and the Balancing Principles Statement).

Retail markets: We encourage Ofgem to recognise the benefits of vertical integration. Competition in supply is now well established and Ofgem should focus on developing an environment that sustains competition, in particular by removing or relaxing over-prescriptive regulation (under much of Part C of the supply licence, for example) that frustrates consumer choice.

We are keen to support collaborative work between Ofgem, the industry, and relevant consumer bodies in order to improve the customer's experience. In particular, we believe that the industry is now able to move towards greater deregulation and stronger reliance on self-governance, general consumer law, and voluntary best practice without any detriment to customer protection.

Review of supply licences: We support the forthcoming review and intend to play a full and proactive part. However, Ofgem should be careful not to prejudge the outcome. We were concerned to note that in Ofgem's recent consultation on prepayment meters, for example, certain (in our view highly worthwhile) options appeared to be closed off from the start.

Metering: We remain unconvinced that competition in metering can bring any real consumer benefits and continue to believe that further work in this area would not be a good use of Ofgem's resources.

Chapter 4: Regulating Network Monopolies

Incentive-based regulation: We strongly support Ofgem's commitment to the principle of incentive-based regulation. Ofgem is also right to seek an improved understanding of the resilience of distribution networks. Such work would be consistent with Ofgem's new legal duty in respect of sustainable development.

Cost reporting project: We are also pleased with Ofgem's commitment to the progressing of the price control review reporting project to a robust conclusion in 2005/06. We believe that, as part of this project, Ofgem should undertake a specific workstream to develop its and the industry's understanding of network cost drivers, since this would help to improve the quality of the cost-efficiency analysis which Ofgem will need to do for the next price control review. We would be concerned if Ofgem's new self-imposed budget cap were to impair or prevent the development of detailed audit arrangements for the distributors' accounting data under this project.

Network investment: We agree with Ofgem on the need for substantial new investment to replace ageing network assets and improve network resilience. A clear implication of this is that Ofgem should consider the financing challenges posed by the increasingly exhausted balance sheets of electricity distributors and review how best to encourage the entrance of additional equity. Responding to the recent Treasury/DTI report on the public policy consequences of higher gearing should form part of this work.

General: The key challenge for Ofgem in network regulation is to maintain and preserve strong equity investment models through a better understanding of the network financing challenge and by incentivising replacement capex. It will also be critical to develop a clearer view of the different respective cost drivers for underground and overhead networks in order to improve Ofgem's efficiency benchmarking procedures and analysis.

Chapter 5: Security of Britain's Energy Supplies

Informing the debate: We are encouraged to know that Ofgem will continue to examine security of supply under a number of different scenarios. Of course, it will be important for Ofgem to inform the market of its findings so that participants themselves can contribute fully to the debate. We also think there is scope for Ofgem and the industry usefully to undertake research into certain matters – for example, the pros and cons of capacity support mechanisms – on a joint basis.

Electricity generation: We note Ofgem's view that price signals are delivering a clear message to the market and have triggered the right response to the need for new investment. We accept that this view appears to be supported by recent announcements concerning the plans for new CCGT generation at Langage, Pembroke, and Grain. However, a number of factors contribute to the decision of vertically integrated generators to construct new plant, of which long-term price signals are only one example. In addition, we should like to emphasise that capacity is not the only factor that contributes to security of supply. Diversity of generation and/or fuel supply is also a key factor. It is not yet clear that the market adequately signals the need for diversity.

Chapter 6: A Leading Voice in Europe

In view of the maturity and scope of the UK energy regulation framework, we believe it is both inevitable and desirable that Ofgem will have a leading voice among European regulators. As our covering letter suggests, we hope that Ofgem will use that voice to ensure that an effective single energy market is developed wherever possible and that a reasonably consistent approach is taken towards both the principles and practice of regulation.

Chapter 7: Protecting the Environment

Delivering a low carbon future: While we note Ofgem's reliance on market-based mechanisms for a successful implementation of the EU emissions trading scheme, our own view – which we have made clear to government – is that the current expectations of this scheme may be more than the scheme is capable of delivering. This suggests that stronger political leadership, and much clearer policy measures and economic incentives, are likely to be required.

Administering government programmes: We endorse the view that Ofgem should administer the government's environmental programmes as efficiently and effectively as possible. However, we also believe that Ofgem needs to take a more pragmatic view in administering the Renewables Obligation, in particular by applying the rules in a reasonable and realistic manner.

Chapter 8: Helping to Tackle Fuel Poverty

Ofgem's role: The nature of Ofgem's legal duty towards vulnerable customers requires that Ofgem should pay close and continuing attention to the impact on such customers of all relevant regulatory and market changes. At the same time, Ofgem should be rigorous in advising government of the actual or potential impact on the fuel poor of its own policies. Ofgem should also aim to foster a climate in which suppliers can be confident that they will not be penalised for introducing innovative social products.

In particular, the industry needs Ofgem to continue to support better targeting of fuel poor customers by encouraging other government agencies to become more involved and to share data. We believe that a concerted campaign to identify vulnerable at-risk customers is both possible and desirable, and, along with the other major energy companies, we shall be working with the Energy Retail Association to take these proposals forward.

Chapter 9: Improving Ofgem's Efficiency

We are pleased to see that Ofgem has responded so positively in this plan to the industry's long-standing discontent with Ofgem's costs and policy process. We particularly support the introduction of an RPI-X budget cap, which should enable Ofgem to reduce its running costs without compromising key regulatory projects. As regards its policy process, there is scope to improve Ofgem's regulatory impact assessments through more rigorous and realistic attention to the implementation costs faced by industry participants.

EDF Energy, March 2005