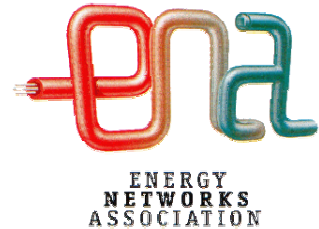


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Andy MacFaul
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4 March 2005



Dear Andy

Re: Ofgem Proposed Corporate Strategy and Plan 2005- 2010

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 five year Corporate Strategy for 2005-10. ENAs comments are confined to those themes which will directly impact on the energy networks sector, in particular that relating to regulating network monopolies.

Regulating Network Monopolies

Currently this section conveys the impression that there are a very large number of issues which need to be addressed over the next five year period. The document states that *"..a major challenge over the next five years will be to ensure that the regulatory regime allows for and incentivises increased investment where this is needed for asset replacement, for network resilience and to respond to changing supply and demand patterns.."* In reality, the conclusion of the latest price review of the Distribution Network Operators (DNOs) and its subsequent acceptance by the companies means that Ofgem has now effectively concluded a five year contract with the DNOs which have a large number of fixed parameters. This will severely constrain Ofgem's ability to alter the regulatory environment in which the DNOs will be operating over the next five years. This should be acknowledged along with some direct reference to the Distribution Price Control Review 4 (DPCR4) settlement in the context of Ofgem's Corporate Strategy. Indeed, in certain areas the Strategy is in conflict with DPCR4 settlement. For example, in paragraph 5.24, the document states *"For electricity, there is a need for substantial increases in investment to replace ageing assets and to improve network resilience."* However, the DPCR4 Final Proposals for the period 2005-10 rejected the DNOs request for extra Capex to improve network resilience and instead provided only an Opex allowance to improve operational practices such as vegetation management.

What should also be made clear in the document is the need for all stakeholders to think about how regulation should develop both through to 2010 and beyond. In this context, the forthcoming transmission and gas distribution reviews will be important milestones ahead of the next electricity DPCR5. We therefore welcome Ofgem's proposal to review the lessons learned from DPCR4 and, in particular look forward to the workshop it has organised with ENA members and the subsequent consultation process. The ENA is very happy to engage with Ofgem in examining how the regulatory framework for network monopolies should be adapted to

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accommodate for the expected changes in the energy environment. In particular, we believe it is very important that Ofgem start thinking now about the objectives for the next DPCR5 and establishes some key regulatory principles at an early stage of the process. This will do much to enhance both the predictability and stability of the next review process to the benefit of all concerned.

Europe

We are pleased that Ofgem has continued to make Europe one of its seven strategic themes and recognises that Europe will continue to become increasingly important in shaping the regulatory agenda. Some of the challenges Ofgem faces in Europe include the development of more liberalised markets where needed and the development of regulation consistent with such an environment.

ENA recognises Ofgem's commitment to engaging with other European regulators and the European Commission, and are pleased to see initiatives such as the seminar on Europe and Energy which took place on 3 March. We also welcome Ofgem's attendance at ENA's recently formed Europe Committee, which along with DTI membership enables members to debate issues in an established forum.

Ofgem's efficiency and effectiveness

ENA recognises that Ofgem has made positive improvements to its consultation process by engaging with the industry early on in the process and encouraging open debate through the establishment of joint working groups on specific issues. This has helped to maintain dialogue between members and Ofgem which, I am sure, improved the quality of the output that was finally produced.

ENA members welcome the step taken by Ofgem in placing itself under an RPI-X cost control regime from April 2005 and the development of the performance indicators set out in Appendix 2. However we note at paragraph 9.5, Ofgem makes reference to a "safety net" whereby Ofgem can go to its Audit Committee to seek additional budget should there be significant additional costs. This has obvious parallels with the uncertainty mechanism developed in the recent electricity distribution price control. However, we are not clear why a contingency figure (which has increased from £0.5m in 2004/5 to £2m in 2005/6) is still a feature of Ofgem's budget as contingency amounts are generally removed during price control reviews.

ENA members have in the past expressed their concerns over indirect costs imposed on companies. Therefore we are happy that Ofgem recognises this and intends to improve its consultation, reporting and review processes, including the way it gathers information from companies to consider how it can reduce the burden placed on them. We believe it is of utmost importance that the costs to the industry are considered before regulatory projects are initiated. When issuing consultations Ofgem needs to take full account of the effects on industry resources and therefore should actively monitor and manage the volume of consultations it produces. We also hope to see further engagement between industry and Ofgem in drawing up Impact Assessments, as stakeholders are often better placed to provide information on likely implementation costs.

We would like to see more detail provided in the appendices of the final Corporate Strategy in respect to a number of points. In earlier corporate plans, Ofgem provided budget cost figures for different strands of work for the projected three year of the period of the plan. This approach was suspended for the 2004-07 plan period, because the introduction of an RPI-X cost control mechanism was planned but the necessary analysis had not been carried out in order to finalise the mechanism. Now that Ofgem has announced its RPI-3 budget cap to apply from April 2005, it would be useful to be able to see budgets presented for those five years of the current plan

period. We also note that Appendix 1 only addresses deliverables for 2005/06, and hope that the final document intends to provide key deliverable for the full five years.

I hope you find our comments helpful. We look forward to the publication of Ofgem's final Corporate Strategy and Plan.

Yours sincerely

A handwritten signature in black ink, appearing to read "D M Smith". The signature is fluid and cursive, with the first letters of each word being capitalized and prominent.

David Smith
Director of Policy