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Mr Andy MacFaul
Head of Government Affairs
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4th March 2005

Dear Mr MacFaul

**Ofgem's Proposed Corporate Strategy and Plan 2005-2010:
Response to consultation**

Indepen is a strategic management consultancy that works with companies and regulators in energy, telecoms, water, transport and other public services. This response to the consultation reflects our experience of working in these sectors and our approach to regulation. However, it represents our own views and has not been prepared on behalf of, or funded by, our clients. Our response is not confidential.

Ofgem's Corporate Strategy is an important document which should be of concern to all organisations touched by its activities. Much of the plan is sensible. We wish to make some observations on two important areas: Europe and deregulation.

Europe

Ofgem plans to commit resources to influencing the European agenda. According to Ofgem, most respondents to its previous consultation thought that Europe should be one of its major priorities. Ofgem sets ambitious strategic goals for Europe. These include fully liberalised wholesale energy markets in Europe with fair and non-discriminatory access, particularly to the gas transmission infrastructure.

Recent EU Directives and Regulations for gas and electricity make these objectives explicit and there appears to be little room to question the preferred direction for the development of European markets. Ofgem's attention to Europe presumably stems from a view that there are significant risks that these goals might be compromised or delayed as a consequence of the way in which they are implemented.

Ofgem sets out its intended position on any debate about European energy policy and its implementation. This includes the view that markets deliver important policy objectives (such as security of supply) more effectively than centralised arrangements. Underlying this, Ofgem appears to hold the view that:

- market-based approaches in the UK have worked well in achieving policy goals
- the UK's markets and regulatory frameworks must be protected from the impact of European policy and regulation
- what is right for Britain is also right for Europe
- what is right for Britain now will continue to be right for Britain as Europe liberalises its markets further
- regulatory and policy "harmonisation" between European states should be minimised
- Ofgem can play a significant role in influencing outcomes in Europe

These views, which might be characterised as "Fortress Britain", might be correct but the approach set out in the Corporate Strategy document is naïve. The eventual shape of the European market and regulatory arrangements and the transition to them will involve the need for political compromise. Securing the best possible outcome, given competing agendas and objectives among European governments and regulators, will be a complex process. European governments and companies have devoted significant resources to shaping existing arrangements and the practicalities of influencing them should not be underestimated. There is certainly little indication thus far that the requisite commitment or expertise will be forthcoming. The Corporate Strategy document does not assess how effective Ofgem might be in achieving its aim of influencing these outcomes.

Ofgem's consultation document ignores the possibility of second-best or least-worst outcomes and the impact that different transition paths might have on the UK market and companies. European companies and governments might reasonably be expected to be reluctant to change quickly the arrangements with which they are familiar and this might be manifested in different interpretations of the Directives.

We think that Ofgem should be clearer about these matters. Otherwise it will risk wasting its resources. Three sorts of questions seem germane:

1. What are the appropriate roles of Ofgem, government and other organisations in influencing European energy policy? How will these roles be co-ordinated? Are Ofgem's resources best utilised in such a role or might this be best left to others?
2. How important are the channels of influence open to Ofgem? How much influence do ERGEG and CEER really have? How much influence does Ofgem have over these bodies? Would other channels be productive, for example the European competition authorities?
3. What consideration has been given to the best strategy for influencing outcomes? Have alternative outcome scenarios and the potential transition paths been considered? How might more effective strategy and tactics best be developed?

Deregulation

The Corporate Strategy refers to a number of instances where Ofgem has taken or intends to take action to reduce the burden of regulation on companies. The project to review supply licences is an example.

In other cases, Ofgem asserts the need for continuing to regulate markets that have become more competitive or where Ofgem's regulatory activities replicate, or at least complement, those of other regulatory agencies. The consultation document rarely makes a convincing argument for the preferred proposals in either of these circumstances.

These observations might suggest that deregulation, while apparently recognised as an important goal and one which many energy businesses would support, is not receiving the coherent and strategic attention it needs.

We believe that Ofgem has the opportunity to promote deregulation and that its Corporate Strategy should do so. In particular, we believe that Ofgem should:

- Engage in an open debate with industry, government and other regulators on areas where there is potential for deregulation, for example in monitoring corporate transactions or in business and domestic supply markets
- Evaluate existing regulation in these areas by considering a full range of options to the status quo, including, for example, regulatory forbearance subject to regulatory triggers
- Commit to relaxing or removing regulation, unless continuation is explicitly justified
- Where the evaluation concludes that regulation remains necessary, state what conditions would trigger a relaxation, how it might be achieved and then commit to deregulating once these conditions are in place.

We hope that these views serve to help and encourage a robust debate regarding Ofgem's strategy and role.

Yours sincerely

John Hargreaves
Director