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 22nd February 2008

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01/08b Ofgem Proposed Corporate Strategy 2008-2013

Dear Andy,

Please find below our response to your recently published Corporate Strategy document.

We largely support the themes in the document but have identified a number of further points for consideration. These are detailed under the seven themes.

1. Creating and Sustaining competition

The 'Creating and Sustaining Competition' theme remains valid and the relevant issues have been identified within this theme.

We particularly welcome a review of the guaranteed and overall standards of performance imposed on suppliers. We believe that the current GS/OS standards do not sit easily with a commitment to the principles of better regulation. Similarly, Ofgem is currently consulting on a proposal to extend the existing market licence condition by a further year. We would prefer to see removal of this condition in the interests of deregulation.

As a more general point, there is evidence that Ofgem is increasingly adopting a role as a social regulator. Examples include:

- The two CSR reports in 2007
- The new licence condition on timely recalibration of PPMs as part of the supply licence review
- The new licence condition on carbon monoxide checks as part of the supply licence review
- The debt and disconnection "best practice" report in January 2008
- Ofgem's consumer first initiative
- Ofgem's imminent role in setting complaint handling standards
- It's review of the Ombudsman scheme
- And, there is the doubling of CERT.

All of these developments cast serious doubt on the suggestion in para 1.17 of the proposed corporate plan that the retail energy market will become increasingly like a normal service industry market. It is plain that the reverse is the case.

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2. Regulating Networks Effectively

The 'Regulating Networks Effectively' theme remains valid and most of the relevant issues have been identified within this theme. We believe this is a fundamental activity for an energy sector regulator to focus on, particularly given the future investment requirements.

It is disappointing that the Transmission Access Review has stalled somewhat, with the latest document containing no firm proposals, merely suggesting further analysis of potential access models. We believe that there is a need for additional infrastructure and the problems Ofgem identify are more about a shortage of capacity than access per se. Clarity on the extent of any access reform, particularly in relation to existing rights, is needed to avoid undermining investment. We would support the development of arrangements that fit within, and complement the existing access framework, recognising that there are challenges and opportunities associated with connecting renewables in certain geographical areas in Great Britain and that specific arrangements should recognise these.

Offshore wind generation can play a key part in meeting government's renewable objectives and designing a regulatory and commercial framework that will support the efficient development of transmission networks for connecting offshore generation to the onshore grid is an important aspect of Ofgem's work. We are not convinced that the complex nature of a regime based on a non-exclusive model will provide a sufficiently attractive investment framework for prospective Offshore TOs and generators. We will however continue to work with Ofgem in developing the details of the regime.

Our preference would be to utilise current onshore mechanisms where possible to connect the Scottish Islands unless there are demonstrable reasons why they are not applicable. We have yet to see a convincing argument why the incumbent monopoly TO in that area should not build the assets under existing price control arrangements.

3. Helping to Protect the Security of Britain's energy supplies

The 'Security of Supply' theme remains valid and most of the relevant issues have been identified within this theme. We support the Ofgem approach and the commitment to use market solutions, wherever possible to deliver security of supply.

It can be anticipated that in future years, a considerably greater volume of intermittent, mainly renewable generation will be commissioned. One issue that is not mentioned in this plan is the effect that this may have on the level of generation margin required to meet peak demand. This is an area that Ofgem may wish to consider prior to the publication of the next Energy Markets Outlook report at the end of 2008.

4. A Leading Voice in Europe

The 'Leading Voice in Europe' theme remains valid and the relevant issues have been identified within this theme.

We continue to support Ofgem's work with European regulators' groups to develop a consistent European regulatory framework including, in the coming year, regulatory oversight at EU level and a workable relationship between the Agency and the ENTSOs with effective stakeholder involvement. We agree that regional markets are a required step towards single markets in electricity and gas and support further work on the regional market initiatives.

We would hope that as Chair of the regulators' Sustainable Development taskforce you would be able to highlight the inconsistencies between promotion of the competitive market and a market-based approach to sustainability through EU ETS with the "very challenging" Renewables Directive's electricity generation targets for the UK.

Liberalisation of the energy market has already brought benefits to UK customers. We support the aim of safeguarding against the danger that overly prescriptive European proposals might undermine these benefits. We look to Ofgem to work with Government to ensure the appropriate transposition into UK law.

As previously stated we would expect any new legislation to be implemented in accordance with the principles of better regulation. Therefore, we would emphasise the need for reporting for transparency purposes to relate to GB wholesale energy markets being flexible and risk-based. Equally, any moves to give a legal basis to the European Energy Consumers' Charter would be a retrograde step in the context of GB's competitive retail energy markets.

5. Helping to Achieve Sustainable Development

The theme 'Helping to Achieve Sustainable Development' remains valid and the relevant issues have been identified within this theme. As noted in the plan, Ofgem has important duties relating to the environment and to sustainable development. It is appropriate that Ofgem continues to advise the Government on its environmental programmes particularly with the introduction of the EU 20 per cent renewable energy target.

6. Helping to Tackle Fuel Poverty

The 'Helping to Tackle Fuel Poverty' theme remains valid and the relevant issues have been identified within this theme.

Para 6.11 notes that mandated social tariffs on a scale needed to eliminate fuel poverty are not consistent with a competitive market. However, it is also true that social tariffs on any significant scale are not compatible with a competitive market.

UK and EU environmental objectives are likely to markedly increase the level of energy prices. It follows that commensurate increases will be needed in the level of support to vulnerable customers. Quite apart from the fact that widespread social tariffs take customers out of the competitive market, many stakeholders have reservations about using suppliers to support the fuel poor on the grounds that the costs would bear heavily on other low income customers. The conclusion is that an urgent dialogue needs to take place with government about a sustainable long term solution to protecting the fuel poor, which does not rely on supplier initiatives as the principal solution.

We are disappointed to note that Ofgem are considering revisiting the issue of debt blocking.

Suppliers put a strong case for the retention of debt objection during the Supply Licence Review in 2006. ILEX, who was commissioned by Ofgem to review this area, undertook extensive research (including how energy debt was dealt with in other countries) and recommended it be retained. Ofgem agreed little has changed since then and it is therefore difficult to understand why this is being looked at yet again.

Despite best efforts to prevent and manage customer debt, the removal of debt blocking provisions would inevitably increase suppliers' exposure to bad debt. Both the tightening of credit controls and a

growth in bad debt would significantly increase suppliers' costs and be reflected in prices to customers. Suppliers' aversion to increased risk could also result in reduced targeting of certain customer segments, thereby actually reducing access to the benefits of competition. These risks and issues are clearly heightened in the light of wider economic pressures and acknowledged levels of consumer debt.

7. Better Regulation

The 'Better Regulation' theme remains valid and the relevant issues have been identified within this theme. We support Ofgem's new commitment to post-implementation review of Impact Assessments as a key aspect of better regulation and look forward to seeing an example.

We note in the document it is stated that 'investors will require a stable political and regulatory environment before making investment in new generation capacity.' We support this view but fail to see how this position can be reconciled with the recent statement from Ofgem regarding a windfall tax on energy companies, particularly at a time when additional generation investment of the order 20 – 25GW is required by 2020.

Ofgem is currently involved in a number of initiatives such as green supply guidelines and new consumer representation. It is our view that it should adhere to the principles of better regulation and not seek to be overly prescriptive with regards to regulatory outcomes. This will allow light handed or self-regulation to complement rather than hinder the development of the market.

We would like to reiterate our previous comments on the proposed review of industry codes scheduled to take place over the next two years.

We noted in our reply to your initial letter on this subject that the present structure of industry codes largely result from changes made at the time of NETA. These arrangements have been developed and refined over time with the addition of new codes. We believe that the current codes, despite some inconsistencies, have worked satisfactorily. The governance arrangements have played their part in securing one of the most robust energy systems in the world. Our initial view is therefore that we welcome the review, and the possible removal of Ofgem from the day to day micro-management of codes, but do not expect radical change to the existing regime.

Further, it must be recognised that we operate in a complex industry, which at times requires complex rules. These rules should only be simplified where it brings clear and demonstrable benefits to industry and customers. To this end we welcome the removal of barriers to small players that prevent them operating on an equitable and transparent basis but not those which discriminate in favour of specific classes of participant or undermine the principle of cost reflectivity.

We do not support the inclusion of environmental objectives within industry codes. The addition of such objectives would add additional complexity to the decision making process at a level that is inappropriate. It is better that these environmental objectives remain part of Ofgem's wider statutory duties.

If you wish to discuss any aspect of our response, please do not hesitate to contact me.

Yours sincerely

Terry Ballard
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