

Andy MacFaul
Head of Better Regulation
The Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

98 Aketon Road
Castleford
West Yorkshire
WF10 5DS
tel (01977) 605938
fax (01977) 605811

Via email

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Dear Andy

OFGEM'S FIVE YEAR STRATEGY 2009-2014

Thank you for the opportunity to respond to Ofgem's five year strategy. We shall concentrate on those matters that are relevant to electricity distribution network operators (DNOs) although we recognise that Ofgem's priorities must balance the range of activities for which it is responsible.

It is evident that the industry is operating against a background of changed statutory duties for the Gas and Electricity Markets Authority and the EU's agreement on a binding 20% renewable energy target. These changed strategic drivers suggest a wide range of long-term issues to be considered in Ofgem's policy making, reflecting global concerns over security of supply and the environmental impact of human activity. Some of these issues relate to an increased role for distributors, whether incremental (such as supporting smart meter roll-out) or radical (such as trading energy services).

The significant challenges in the short to medium term that Ofgem needs to take in to account are:

- the steep and sustained rises in input prices;
- the significantly increased public sensitivity to overall energy price rises;
- the clear evidence that the electricity distribution companies are not outperforming their operating cost allowances;
- the greater uncertainty in the capital markets; and
- the increasing environmental pressures and targets.

These factors will be particularly important in the completion of the current electricity distribution price control review (DPCR5).

The RPI at 20 review is an important priority for Ofgem. This project must set the priorities and mechanisms for the next ten years. Ofgem and the industry need to develop the existing regulatory framework to become one that incorporates the new duties and activities referred to above, is flexible and sustainable enough to respond to the changes that will arise and deals with uncertainty whilst maintaining consistency and stability to secure the confidence of investors in long-term assets.

It is vital that the regulatory framework recognises and encourages appropriate behaviours such as good stewardship, cost-risk management and effective business planning and performance, particularly in times of volatility and uncertainty.

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Specifically the regulatory regime must:

- *Recognise and challenge reasonable cost increases* - we think that customers are now concerned about price and want us to maintain network risks at reasonable levels at a reasonable price.
- *Get the environmental signals right* – delivering appropriate network investments remains the DNOs' main contribution, but other smaller, more specific contributions should be encouraged. Stakeholders other than customers may want more than customers are willing to pay for.
- *Encourage appropriate behaviours and good cost-risk management* - if the proposals are balanced then good management teams will accept the cost-risk management challenge – Ofgem needs to send a clear signal that delivery on commitments matters, credibility counts for something and reasonable proposals are properly compensated.
- *Recognise that secure (high quality) investor confidence is more important than ever before* – market return expectations have not changed whereas risks are increasing both in absolute terms and relative to any residual scope for ongoing out-performance. An appropriate cost of capital is essential to properly compensate the risks, to ensure that the network businesses can effectively compete for capital going forward and to retain a healthy proportion of equity in the sector.

Ofgem's plans for the next five years should reflect these priorities particularly in the completion of the DPCR5 project and the RPI at 20 project.

Yours sincerely



Jim Cardwell
DPCR5 Programme Manager