

27th February 2009



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

Dear Andy

Ofgem Corporate Strategy 2009-2014

Energy Networks Association (ENA) is funded by the major licensed electricity and gas transmission and distribution companies in the UK. We welcome the opportunity to respond and contribute to Ofgem's five year Corporate Strategy for 2009-14.

Overall, we believe that the seven themes identified in Ofgem's Corporate Strategy and Plan are still valid for the assigned period. However, the challenges of developing a more sustainable energy system and maintaining secure supplies are probably the most significant issues facing Ofgem over the period to 2014. Indeed, the paper acknowledges in Para 3.5 that 'sustainability is at the heart of our (Ofgem's) policy and decision-making processes'. To acknowledge this, consideration should be given to re-ordering the themes and giving greater prominence in the document to sustainable development and security of supply. This would also be in keeping with the change to Ofgem's duties which has emphasised the importance of the interests of future (as well as existing) customers and promoted sustainable development within the hierarchy of its duties.

In relation to the detail within the proposed Plan, ENA's comments are confined to those themes directly impacting on the energy networks sector.

1. Creating & Sustaining Competition – Theft of Electricity and Gas

We are disappointed that Ofgem has shown little interest in seeking to resolve the conflicting incentive arrangements for detecting and preventing theft of electricity and gas which have been in place for almost 10 years. Moreover, it is over 4 years since Ofgem last consulted on the issue despite receiving the ERA/ENA Theft of Energy Working Group Report early in 2006 and agreeing to consult on it shortly afterwards.

ENA therefore is pleased that Ofgem is now planning to consult on proposals to strengthen incentives on industry participants in this area during 2009/10 and looks forward to participating in the consultation process. We believe the time is right not only in view of the current DPCR5 timetable but also in the light of the current UNC discussions that are underway.

2. Regulating Networks Efficiently

ENA supports Ofgem's RPI-X@20 project and is participating fully in it. In the context of the sustainability agenda and the need to secure supplies of energy, we agree that

the time is right to develop a regulatory regime that recognises the need for a sustainable approach to network development.

DPCR5

We have in the past expressed concern that discussions concerning longer term issues, including sustainability, risk being conducted in a “long term vacuum”, particularly as a result of the delay in publishing the output from the LENS process and integrating it into the current DPCR5 review. Whilst this has been remedied to some extent by the publication of the LENS work there remains an impression that this work is somehow proceeding in parallel with the conventional review process rather than being integrated within it.

Work is continuing on efficiency analysis, specification of outputs to underpin investment plans and measures to better incentivise companies to submit realistic capex plans. Elsewhere in the DPCR5 process DNOs are being encouraged to ‘future proof’ their networks, become highly innovative, increase their contact with key customers and stakeholders and break free from the shackles previously imposed upon them by rigid business separation rules and tight RPI-X regulation.

We strongly believe that Ofgem should seek to integrate these two areas of work, and ensure that there is an appropriate balance between the shorter term priorities associated with the conventional RPI-X model and the longer term requirement to adapt the networks to accommodate a low carbon economy. We trust that the RPI-X@20 project will also acknowledge this.

Future Regulatory Framework

ENA members fully support incentive-based regulation. The incentive based approach to implement Ofgem and Government objectives, for example to improve customer service, encourage innovation, ensure reliable capex forecasts and reduce methane emissions is enabling behavioural changes that benefit customers.

ENA members are keen to play their full part in helping to tackle climate change and deliver Government’s energy policy objectives. They are actively looking at how future changes in energy policy will impact their networks and are engaging in the debate about what this might mean for their own span of operations. The GDNs are already assessing the potential for bio-gas entry into the network and working with DECC therein, as well as working hard to ensure the success of the networks extension scheme for fuel poor households and communities.

The DNOs and GDNs are very supportive of an expanded role in helping to deliver climate change and are ready and willing to take up the challenges presented, including working with generators and customers on demand-side issues including energy efficiency, zero carbon homes, ‘experimenting with new commercial arrangements’, supporting the roll out of smart metering or developing innovative solutions to accommodate the new forms of generation and bio-gas connecting to the networks. However, for this to become a reality it will require clarity from Ofgem on the roles and responsibilities in this new environment; it will also need a supportive and coherent regulatory framework, which explicitly recognises the new activities being undertaken by the DNOs and GDNs, the extra resources that will be required and the increase in risk that they will have to bear. Appropriately designed incentives will also be necessary to specify the desired outcomes in this wider context. However, they will have to be flexible to recognise and adapt to changing circumstances, while still preserving the overall incentive.

Balancing Risk and Return

A key requirement of any regulatory framework is to ensure that the confidence of the financial community is retained, even during difficult economic circumstances. Increasing network investment will require the provision of significant amounts of finance from the investment community. If the current circumstances persist it will mean higher financing costs and more restrictive debt covenants. Prospective investors must therefore be re-assured that all efficient expenditure by the companies is recoverable and that the rewards available to them are commensurate with the risks they are facing in transforming their networks.

A consequence of this will be the need for mechanisms within the price control that deal with the inherent uncertainty that will characterise the next 5 years and beyond. In particular, for those risks over which the companies have little control such as changes in obligations, then the regulatory framework must ensure that the risks are apportioned fairly between them and their customers.

Transmission Issues

In transmission the TNOs need to be confident that they can progress planned investments despite the significant uncertainties in transmission related charging, in order to avoid potential security of supply problems in the medium term.

In addition we would suggest that there is now an opportunity to progress 'round 3' offshore transmission networks by extending onshore licensed transmission areas offshore, rather than through the line-by-line auctioning approach used in 'round 2'. We believe that consensus is developing amongst the major stakeholders, i.e. TNOs, potential offshore generators and environmental groups, that this is a more economic and sustainable approach.

Regulatory Reporting

ENA members have participated fully in Ofgem's cost reporting projects for both the transmission and distribution companies in electricity and gas. The objective has always been to streamline the amount of data requested from the companies and so reduce the burdens on companies. However, concern has been expressed recently by some of our DNO members that there has been an increase in the burden during DPCR5.

3. Helping to Achieve Sustainable Development

We feel that all aspects related to this theme have been covered in previous sections but would like to raise two points about the development of distributed generation.

First, we welcome the confirmation in the document that incentives on network businesses to connect renewable and other plant will be strengthened. We were also pleased to see in the DPCR5 Policy Paper, Ofgem's recognition that the primary factor inhibiting the growth of distributed generation is not the behaviour of the DNOs but, as ENA members have pointed out on many occasions, the difficulties in obtaining planning permission for its development.

4./5. Security of Supply & Europe

In this instance, as the two themes are currently intrinsically linked, we have decided to merge our comments for Security of Supply and Leading Voice in Europe.

Given the UK's increasing reliance on energy imports, we believe that security of supply and our involvement in European developments is becoming evermore vital

and needs to be properly managed. We fully support Ofgem's focus in this area and are glad to see both national and international aspects contained in the Strategy.

Although contingency measures are mentioned in the Strategy some mention of the importance of gas storage would have been a welcomed addition with the UK storage levels far below those in mainland Europe. This results in the UK being both affected in a security of supply capacity and by volatile gas prices.

As far as transportation of gas to and from Europe is concerned we are certain that our members will be able to help progress this piece of work along with DECC, HSE and the European Commission with their wealth of knowledge and expertise in this area. The UK's emergency plans are robust and have been significantly developed and tested over time. We would however suggest that as a priority emergency arrangements be considered that take account of the UK's interconnection links and create plans with the associated parties.

ENA supports all the ongoing work around the SER II package and the review of the 2004 Security of Supply Directive and the ENA and its members are actively involved in these developments. We hope Ofgem can help support the EU incentives as we still do not feel that the current EU regulatory framework fully supports security of supply in the UK gas market and that substantial investment is needed to expand the current infrastructure.

7. Better Regulation

ENA welcomes the work done by Ofgem in creating better regulation and simplifying the current arrangements. ENA fully support the Code Governance Review process, involving focus groups, working groups and extensive consultations. Although we clearly value wider stakeholder involvement, it is vital that the outcome of the Review does not put additional strain on the industry once implemented

The ENA and its members find the Simplification Plan and items therein relevant. We would however like consideration to be given to bringing forward a review of the Gas Distribution Licence to mid-2009 if this is feasible. The licence was developed from the previous Transco licence to ensure a smooth and fast sale of gas distribution networks but there was insufficient time to review the appropriateness of some of the conditions. A full review is required to ensure that obligations are appropriate, efficient and provides customer benefits as well as making the licence easy to understand and use. Our members would support such a review and would like to engage with Ofgem on such an initiative.

We hope that you find these comments useful.

Yours Sincerely



David Smith
Chief Executive
Energy Networks Association