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Dear Andy

Ofgem's Corporate Strategy 2009-14

I refer to your consultation on the above and appreciate the chance to comment.

Whilst we are broadly supportive of the proposed programme, it must be stated that Ofgem's plans are being formulated during the worst recession for decades and the near collapse of the banking sector. Any plans Ofgem have for the next five years must take into account the likelihood that the recession or its consequences may reverberate for most of this five year period. This is going to affect the way DNOs can finance their activities and is of course a factor that is being considered as part of the ongoing Distribution price control review.

The proposed Ofgem strategy also comes at a time when the new DECC Select Committee is launching an inquiry into the future of Britain's electricity networks which they anticipate feeding into Ofgem's RPI@20 review. Many of the questions posed by the Committee in its call for written evidence are issues Ofgem will have to tackle in the next five years.

With regard to the precise proposals in the corporate strategy and plan, we would particularly refer you to our detailed response of 25 September 2008, and we will therefore restrict our comments to a small number of the most important issues of particular relevance to DNOs based on your established themes.

Creating and sustaining competition

We commented last year about the volatility in wholesale prices as the price of oil decreased. However, that scenario quickly changed and the rapid rise in wholesale and retail prices and the economic recession has made the ability to retain customer's faith in the competitive market more difficult. We welcome the fact that despite pressures to intervene, Ofgem has generally resisted the temptation and this balance which we referred to last year will remain difficult to maintain as the recession deepens.

We have been a consistent supporter of competition in the metering and connections markets whilst recognising that striking the balance between competition and regulation is essential in these areas where competition has been developing in recent years. With regard to connections we would reiterate the hope that the focus will remain on making the existing market for contestable services more effective across the whole country. We have presented independent evidence to Ofgem demonstrating the significant level of competition in the North West of England unlike some other parts of the country and we hope this will be recognised by Ofgem in the development of policy in this area and during the Distribution review discussions.

Regulating networks effectively

In this turbulent economic climate, the results of DPCR5 and the regulatory framework in general must send out important messages of regulatory consistency to potential investors and it will be even more imperative that the DPCR5 process demonstrates clearly what customers will be getting for their money. To meet the needs of our customers and other key stakeholders Ofgem and DNOs need to develop a regulatory framework that acknowledges the full extent of the investment programme we must undertake. The DPCR5 price control must recognise that the DNOs require significant levels of financing from the investment communities to deliver the required outputs. Whilst the utilities sector has been viewed as a reasonably low risk investment in the past and attracted comparatively low interest rates, the current circumstances are likely to result in higher financing costs with more restrictive debt covenants for a number of years.

Ofgem's strategy in the medium term will need to display considerable flexibility during the economic downturn and encourage equity investors by giving the reassurance that if the costs of new debt are greater than assumed in the forthcoming Distribution review settlement a mechanism exists for Ofgem to fund these costs, where companies have acted appropriately. We believe that to ensure that future investment is delivered efficiently and protect prices for customers in the medium to long term, the broad incentive properties of the current price control must be maintained. It is important that future incentives allow the DNOs to focus on managing the network for customers at the lowest whole life cost and also make the employment of Demand Side Management schemes a more realistic possible alternative. Ofgem's strategy must ensure that the DNO's minimum cash requirements are met and the ability of DNOs to adequately finance their activities over the medium term will be a significant challenge for Ofgem as part of its statutory duties.

Security of supply

In addition to our comments above, the repeated question for DPCR5 and for the future generally is the extent to which customers wish to pay for improvements to their quality of service. The current and medium term economic downturn makes the likelihood that customers would want to pay more even more unlikely. It is clear from recent Government consultations and policy developments that there has been a change in approach to energy policy with an increasing narrative on the need for green jobs and the need to build other energy infrastructure to underpin security of supply. Ofgem's new Energy Act remit and the increasing emphasis on the need to fund renewable energy projects and the infrastructure to support them must be a key focus of any strategy.

Sustainable Development

In addition to the global economic crisis, we also face unparalleled environmental challenges. We recognise that DNOs have a significant role to play in the movement to a low carbon economy and must minimise their own impact upon the environment. We have engaged in discussions on environmental issues to the fullest extent, and have responded positively to the relevant incentives placed upon us. Equally, we do not expect any DNO to pay for pre-emptive action where there is no confidence of cost recovery.

However, we recognise for the future that the long term benefits to consumers of actions now to support renewables are potentially significant and may warrant a change in the risk/reward balance and a consequential expansion of the DNO role over time. In order to achieve this “next level” in terms of environmental issues requires adjustment of the regulatory framework to support the change in focus.

The facilitation of a low carbon economy is an important strategic driver for developments such as the Distribution review, impacting on issues such as the revenue driver, losses, DG and smart meters. The DG incentive should be retained as the means to set a DNO’s allowed revenue from generation customers. However, the Ofgem strategy needs to explicitly recognise that the regulatory framework needs to evolve to allow the network companies to promote and encourage further DG development and connection. Ofgem also have the opportunity both as part of the Distribution review and the next few years to remove a number of regulatory barriers to the further development of environmental best practice. We would argue specifically for the removal of the units distributed revenue driver, the equalisation of opex and capex incentives and the merging the demand and generation revenue into one single charging methodology. This final development will enable demand to credit generation where it truly defers network reinforcement investment. We also see the proposed innovation incentive as crucial in bringing forward innovative technical and commercial solutions to DG issues.

The future development of offshore wind generation and new nuclear generation will also be an important element in reducing carbon emissions. It is therefore important that Ofgem can adapt their stance on the regulatory framework to meet these renewable challenges. It is clear that Ofgem will have to match the evolving political drive designed to facilitate renewable energy and try to ensure that the technical, commercial and regulatory barriers to allowing for sufficient network capacity can be overcome.

Better Regulation

We have consistently argued that Ofgem should concentrate on a smaller number of important projects. The proposed workstreams for the Industry Code Governance review and the RPI@20 project should not deflect attention from the ongoing Distribution Review.

I hope you find these comments helpful. I would be pleased to join in further discussion on the issues raised.

Yours sincerely,

Paul Bircham
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Electricity North West Limited