

Andy MacFaul  
Head of Better Regulation  
Ofgem  
9 Millbank  
London  
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17 September 2010

Dear Andy,

### **Ofgem's five year strategy 2011-2015**

We are responding to Lord Mogg's letter of 30 July 2010. I can confirm that this response is not confidential and may be placed on Ofgem's website.

We are entering a crucial period of change for the UK energy industry, in which the decisions made in the next few years will have profound effects on our ability to maintain and deliver affordable and secure supplies, whilst meeting Government targets on greenhouse gas emissions. We are therefore particularly pleased to have the opportunity to input into Ofgem's strategic decision making and prioritisation process.

We set out below what we believe are the most pressing areas for Ofgem's attention.

The current economic climate, and the difficulties faced by vulnerable members of our society should be high up Ofgem's list of priorities. In this respect, Ofgem will need to continue to work with Government and the industry to ensure that the most vulnerable members of our society are suitably protected particularly in the context of increased energy costs driven by climate change policies.

Also, in the context of the current economic situation, and in particular of the need to cut public spending, we believe that Ofgem should look hard to see what savings can be made from its own budget. To assist this, we recommend two broad approaches:

- Firstly, given the scope, complexity and the significant cost of Ofgem E-Serve, we believe that better mechanisms (if any) should be sought for delivery – using competitive selection where possible to ensure improved value and customer focus.
- Secondly, we believe that Ofgem should develop a less interventionist approach to regulating the competitive parts of energy sector. In particular, we believe that Ofgem should re-energise its former belief in withdrawing from regulation where competition is effective, and should set out clear milestones or tests against which it would carry out such a withdrawal.

In respect of the latter point above, we are especially concerned about Ofgem's apparent desire to intervene in the wholesale market to address a perceived lack of liquidity. regulatory intervention is not justified, and will not overcome the diverse non-liquidity related barriers to entry faced by new participants. However, even the threat of intervention creates market uncertainty and undermines the prospects of securing the large investment needed to de-carbonise the sector, particularly in the context of uncertainties caused by other market reviews.

The need for very substantial amounts of private investment in GB energy assets over the coming decade should be central to Ofgem's approach and priorities. Securing the right investments will require Ofgem to make a balanced interpretation of its revised statutory objectives, particularly with respect to an appropriate weighting given to the imperatives of promoting competition, maintaining energy security and reducing greenhouse gas emissions.

A balanced approach will enable Ofgem to build on the preparatory actions identified by the Electricity Networks Strategy Group (ENSG), and to determine and sanction the necessary (least regret) strategic transmission investments necessary to facilitate timely connection of generation at all scales. The transmission system should be appropriate to the future electricity generation mix. Ofgem should ensure that the transmission owners consider a number of potential generation scenarios, rather than relying on a single scenario such as "Gone Green". In this regard, it is essential that Ofgem takes forward the Connect and Manage approach into its TPCR5 decisions.

A balanced approach will also need to be carried through by Ofgem into its contribution to the Government's Electricity Market Reform project, with the aim of developing an enduring design which provides long-term signals for investment, and which incentivises the appropriate provision of energy, capacity and balancing services, as well as increased levels of demand-side participation (via smart grids or otherwise). In a similar vein, we note that Ofgem intends to conduct a fundamental transmission charging review. It is essential that this is conducted in a timely manner to ensure that it provides investor confidence at this critical time. It should also be conducted holistically in order to provide a level playing field and incentives for efficient investment. However, such a review should not in any way undermine the recent Government decision on grid access reform.

It is also important that major industry reform can be facilitated efficiently and effectively given the need for the industry to meet Government's energy policy objectives. Ofgem should take forward significant code reviews in areas where it has been demonstrated that major change is required, and will also need to ensure that relevant licences (TO, SO etc.) are similarly aligned.

Taking a slightly longer-term, but equally important perspective, we support the development of research, development and technology trialling in the networks sector, particularly so that the sector can gain a timely understanding of the benefits which smart grid deployment could bring to GB. In this regard, we believe that Ofgem should ensure the release of LCNF funds which kick-start smart-grid and other projects and which maximise the learning available for DPCR6.

Irrespective of its role in delivery, Ofgem should bring forward a regulatory framework for smart meters which ensures that suppliers can finance their share of the necessary investment at a reasonable cost. In addition, Ofgem should ensure that the specification of both the meters themselves, and the relevant industry processes, ensures the smooth operation of the competitive market for gas and electricity supply.

Ofgem should also continue to take a leading role in the development of European energy market regulation with a focus on ensuring harmonisation of transmission and market rules in an appropriate timescale (but with an appropriate level of subsidiarity). Ofgem will also need to work with Government to implement the EU Third Energy Package in a

sensible and practicable manner avoiding over-interpretation and a gold-plated transposition.

We hope that you will find this response helpful. If you have any questions about it, please contact my colleague Paul Delamare on 020 7752 2187, or myself.

Yours sincerely

A handwritten signature in black ink, appearing to read "D. Linford".

**Denis Linford**  
**Corporate Policy and Regulation Director**