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The Office of Gas and Electricity Markets
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Dear Andy,

OFGEM'S FIVE YEAR STRATEGY 2011-2016

I am responding to Lord Mogg's open letter of 30 July requesting views on the future strategy and priorities for Ofgem for 2011-2016.

In our view, the key challenge for the UK energy industry will be to attract the investment needed to progress toward our domestic and international environmental targets, while ensuring security of supply. This challenge is especially acute for electricity, where significant plant retirements are foreseen under EU environmental rules and there is a need to address the 2020 renewables target. This challenge has become tougher over the past year as the credit environment has remained difficult and the time remaining reduced.

A key task for the Authority over the next 5 years is therefore to help create the framework that will attract that investment. This will involve work both in the Authority's core function of setting price controls for network businesses – especially electricity transmission – and in its function of overseeing code modifications. In particular:

- It will be necessary for Ofgem to approve the necessary transmission investments to facilitate renewable and nuclear generation in a timely manner and at a reasonable rate of return;
- In setting price controls, the importance of credit ratios and the cash position of utilities must not be downgraded. In today's tough financial environment, adequate short term revenues will be vital;
- We have become increasingly concerned that the current framework of locational signals for transmission pricing is not facilitating the cost effective progress towards environmental and energy policy goals. Ofgem's newly announced Project TransmiT will be of huge importance in remedying this;
- In overseeing code modifications, Ofgem should continue to focus on reducing regulatory uncertainty. The potential for changes to the GB regulatory and commercial framework over the life of a long-lived generation

asset are significantly impacting the return required from such assets and acting as a disincentive for investment in GB compared to the rest of Europe. We believe Ofgem should aim to reduce this uncertainty and to signal respect for the principle of grandfathering previous investment decisions.

We would also urge Ofgem to give priority to the smart metering roll-out, particularly given the Government's wish to consider an accelerated programme. It is now even more essential to ensure that the risks of this large and complex programme are well managed, so as to deliver a smooth, efficient and timely transition which minimises costs and disruption for consumers. Ofgem can and must play a vital role in driving this process forward.

Finally, and unusually, a key role for the Authority will be to input into the review of Ofgem that the Government is undertaking. While we think there is little dispute around the core role of regulating networks, the questions become much harder where environmental and social policy impinge upon that role or upon the supervision of markets. It is unclear whether the framework has yet evolved to a stable and self-consistent position on this.

We think that the Authority will need to play a role in helping to shape that debate and also in demonstrating effective use of resources in an environment where public sector budgets are under pressure.

If you would like to discuss these points in further detail, please do not hesitate to contact me.

Yours sincerely,



Rupert Steele
Director of Regulation