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Ofgem's Forward Work Programme 2012-13

Dear Philip,

We welcome the opportunity to respond to Ofgem's proposed Forward Work Programme for 2012-13, and to comment on the key projects planned for this period. Our response is provided on behalf of RWE Npower plc.

We present our comments to the projects listed under the four themes in the following pages, but we provide some high level comments detailed below.

- **Gas Security of Supply** - we believe that the GB market is already widely regarded as the benchmark for a competitive, liquid and efficient wholesale gas market. Further intervention will be detrimental to the market and will increase customer costs.
- **Electricity Cash Out Arrangements** - we believe that the implications of the electricity capacity market introduced under Government's Electricity Market Reform, needs to be fully understood before the electricity cash-out arrangements are reviewed.
- **Review of Enforcement Process** – we would strongly support greater dialogue between all parties, increased quality of updates from Ofgem, and greater clarity over the principal issues of concern. It would also be helpful to avoid long gaps when there is no apparent activity.
- **Smart meters, smart grids and LCNF** - we urge Ofgem to ensure that areas such as customer choice, competition, cost reflectivity and fair charging, and integrity of market design; should be preserved and that consideration be given to the enduring arrangements as the role of the core institutions and their responsibilities are likely to change. Preserving the customer experience and containing costs are key to the successful introduction of smart metering. We are of the mind that 'it is better to do it right, than to do it early'.
- **Project Transmit** - we welcome the fact that Ofgem is minded to rule out socialised charging as an option for transmission charging. We remain of the view that the status quo is the only option that can deliver Government's targets for low carbon energy at least-cost to the consumer.

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- **Energy Company Obligation and Green Deal** - we believe that Ofgem can play a substantial role in enabling a sensible transition from CERT/CESP to ECO/GD, promoting efficiency measures to consumers, providing fora for best practice sharing, and for Local Authority and other stakeholder involvement.

Yours sincerely,

By email so unsigned

Jill Brown

Economic Regulation

Theme 1 – Contributing to the achievement of a low carbon energy sector

We have responded to the relevant projects identified as key to achieving the Government's sustainability criteria, under the corresponding themes 2 to 4.

Theme 2 – Helping to maintain the security of Britain's energy supplies

Key Ofgem projects planned for 2012-13:

- *Implement the proposed **Gas cash out** arrangements as proposed under the Significant Code Review (SCR) that is currently being undertaken in relation to a Gas Deficit Emergency (GDE).*
- *The **review of Gas Security of Supply** will aim to determine the extent to which other interventions may be required to enhance the security of gas supply.*

We believe the current cash-out arrangements provide strong incentives on shippers/suppliers to balance supply and demand and have led to investment in LNG import terminals, increased interconnection and storage projects. Our priority would be to improve the signals that come from the present cash out arrangements, possibly by introducing an administered Value of Loss Load (VoLL), in order to incentivise further investment in both the demand and supply side that will enhance security of supply. We strongly disagree that demand-side response (DSR) should be compensated on the basis of this administered VoLL as this would dilute incentives on the demand-side to sign commercial interruption contracts to prevent an emergency. Furthermore, the proposed cash-out and compensation arrangements will create significant financial and credit issues for short shippers which in turn could lead to shipper insolvency.

Although recent focus has been on cash-out arrangements, Ofgem's preference is also to supplement the proposed cash-out reforms with further interventions. The GB market already comfortably exceeds the infrastructure and supply standard laid out in the Security of Supply Regulation 994/2010 and is widely regarded as the benchmark for a competitive, liquid and efficient wholesale gas market, which the rest of Europe aspires to. Therefore, we believe that any further intervention is wholly disproportionate and will create distortions which are detrimental to the GB market and increase customer costs.

- *Consider undertaking a SCR which would develop proposals for **Electricity Cash Out** arrangements.*

We believe that electricity cash out arrangements should be reviewed but question the timing of such a review particularly with respect to the Electricity Market Reform (EMR). In its technical update released just before Christmas, Government took the decision to introduce a market wide capacity market. We need to understand the detail of such a market before a review of cash out arrangements is carried out. We would also add that both mechanisms are strongly related to security of supply.

Theme 3 – Promoting quality and value for all consumers

Key Ofgem projects planned for 2012-13:

- *Consult and implement proposed reforms to gas and electricity retail markets identified in the **Retail Markets Review (RMR)** of 2011*

With regards to the domestic market, we are generally supportive of tariff simplification although we believe Ofgem needs to be aware of unintentional consequences. We are concerned about the

prescriptive nature of the proposals on bills, annual statements and price change announcements. The proposed Standards of Conduct are useful as a guide to practice, but we consider putting them in the supply licence would not be appropriate until a number of pre-conditions have been met.

In addition, RWE npower has responded separately to the RMR consultation documents and will participate in any subsequent consultations and discussions.

- *Implement reforms to enhance **liquidity** in the wholesale markets.*

We welcome that Ofgem has recognised the fact that the 'Big 6' are striving to improve liquidity and access to the market for small suppliers and generators, and look forward to participating in a further consultation on this issue.

- *Plan to undertake a **review of the enforcement process**.*

In considering the approach Ofgem takes to enforcement, it would be preferable if Ofgem avoided long gaps in communication with no apparent activity.

We also support the approach of developing settlement mechanisms for early resolution of cases.

Furthermore, Ofgem could expand the approach applied to Supply Licence SLC 25A where it initially writes to a supplier in the first instance outlining any concerns, thereby giving the supplier the opportunity for dialogue and response before proceeding to formal enforcement. This would increase the understanding of Ofgem's concerns at an early stage. We would also like to emphasise the importance of Ofgem providing informative, quality updates as outlined in the Enforcement Guidelines.

- *Continue to engage with DECC on the **smart meter rollout** and progress with the **smarter markets strategy review**.*

We would like to provide comments on the following points :

Foundation period – Ofgem should work to ensure that the change of supplier processes and subsequent rules, preserve the following: i) customer choice and experience, ii) competition in supply, energy services, and metering activities, iii) integrity of market design.

Charging principles – Ofgem should work to ensure that the charging principles, price controls, and cash recovery arrangements; preserve efficiency and cost reflectivity, as well as fairness to consumers, competition in supply and enhanced services, and also within the data and communications provision in the business sector.

Mass rollout – Ofgem should monitor the consumer experience and in particular any setbacks, or media activity that give rise to risks towards a positive public perception.

Market design – Ofgem should give consideration to the evolution of the Supplier Hub market model, and in particular consider the contractual arrangements for distribution networks, energy service companies and aggregators; with consumers, suppliers, and with National Grid.

Institutional arrangements – The role of the core institutions (Gemserv, Electralink, Elexon and Xoserve) are likely to change. In the light that some of their functions may correspondingly change as well, Ofgem should give consideration to the ideal enduring arrangements and how the various responsibilities can

be mapped to both existing and new institutions. In addition, Ofgem should also consider the regulatory underpinning of registration, such as service terminations and settlement meter points, as the respective responsibilities of the networks, DCC, suppliers and suppliers' agents change accordingly.

Regulatory oversight of meter operator and rental charges - even where there are no formal price controls or last resort provisions, Ofgem should have an oversight role regarding fair charging, bundling of charging, and entry barriers erected by technology choice or data arrangements (such as file formats).

Incorporation of independent networks in smart arrangements – Independent networks should have as few additional complexities as possible for supply, meter provision and management, and charging.

- *Finalise the first **transmission price control (RIIO-T1)** and the **gas distribution price control (RIIO-GD1)**.*
- *Commence the **price control review for electricity distribution (RIIO-ED1)** in 2012.*
- *Continue to allow funding through the **Transmission Investment Incentives (TII)** and review.*

The industry is facing a prolonged period of investment in gas infrastructure, electricity networks and generation, in order to meet climate change objectives and to deliver security of supply. Given the scale of this infrastructure investment, the market and regulatory frameworks will be key to attracting investment into the UK. Although RIIO provides an overarching framework that reduces the investment risk faced by network companies, we continue to believe that there is a clear role for investing in response to user commitments, although we accept that there is a balance to be struck between ensuring commitment to strategic investment ahead of need, and protecting consumers from inappropriate risks and costs. Uncertainty around the level and timing of expenditure across the eight year price control period will affect the allowed revenue year on year. There is clearly a linkage between revenue predictability and charging predictability, and the basis on which shippers and suppliers set tariffs to recover unknown future network charges needs to be considered.

- *Continue working with DECC on the **Smart Grid Forum**, and consider regulatory changes that might be needed for smart grid development by referring to the smart grid demonstration projects funded through the **Low Carbon Networks Fund (LCNF)**.*

We appreciate Ofgem's role in the Low Carbon Network Fund and the way that this has transformed the engagement between suppliers and network operators in handling the necessary changes to the energy systems and processes that will enable the Low Carbon Transition. In particular, the LCNF has revealed the need for increased understanding "across the meter" between consumers' homes and business premises, and the interaction with the networks.

The development of smart grids is clearly related to LCNF and takes on a wider scope in relation to the operation of the energy system. We believe that consumer engagement with new actors such as energy service companies and aggregators, and distribution network contracting with transmission, suppliers and possibly consumers, could change fundamentally the methods of demand forecasting and the Supplier Hub model for consumer engagement and contracting. We urge Ofgem to continue in its current direction of travel with regards to Smarter Markets.

- *Conclude **Project Transmit** and reach decision regarding any changes to the charging methodology for use of transmission assets.*

We note and welcome, that in Ofgem's recent consultation on 'Electricity transmission charging: assessment of options for change', it is minded to rule out socialised charging as an option for transmission charging. We remain of the view that of the options being considered, the status quo is the only option that delivers Government targets for low carbon energy at least-cost to the consumer. Ofgem's own consultants have provided evidence that this is the case, and we are very concerned that Ofgem's 'minded to' statement is to introduce a charging arrangement that delivers not only no benefit to consumers or the environment, but at an increased cost.

- *Following transposition of the **European Third Package** into GB law. Ofgem will complete the certification of transmission system operators, develop Framework Guidelines and Network Codes, provide conclusions on regulatory arrangements for new electricity interconnectors and an assessment of the European target models for the GB markets.*

We continue to support Ofgem's participation in European energy regulation. In particular, we consider that Ofgem should play a key role in ACER's production of the Framework Guidelines to support both cost-effective implementation of EU policies and market-based mechanisms wherever possible. We also look to Ofgem to work with Government to ensure flexible development and application of any EU requirements and where applicable, appropriate transposition into UK law.

Theme 4 – Ensuring the timely and efficient delivery of Government programmes for a sustainable energy sector

Key ofgem projects planned for 2012-13:

- *If chosen, Ofgem will work with DECC on the **Energy Company Obligation (ECO) Scheme**.*

We believe that the current proposals for ECO targets as set out in the DECC Green Deal consultation, are undeliverable. We have, as part of our response to that consultation, submitted a structured response including our recommendations for measures which we believe would improve the deliverability of the Government's proposals. Energy suppliers need to be confident that Government and other stakeholders will be obligated to facilitate delivery of the ECO targets by identifying sufficient vulnerable customers and suitable properties to ensure that the targets are achievable, and at a cost which is compatible with those identified as the central estimate in DECC's impact assessment.

We would hope that there is certainty in the administration of the ECO and it is not subject to precipitate changes in the application of rules governing it, as these may have a significant effect on arrangements entered into by suppliers which could impact them being able to meet their obligations.

- *E-Serve will continue to work with Government and industry to deliver the **Carbon Emissions Reduction Target** and the **Community Energy Saving Programme** targets.*

The CERT and CESP programmes have experienced significant difficulties in identifying consumers, engaging demand, uncertainties and changes in carbon scores, and in regulatory administration.

There are significant lessons to be learned from CERT and CESP for successful implementation of the Energy Company Obligation (ECO) and Green Deal (GD). In addition to this, there are significant transition issues in the progression from CERT/CESP to GD/ECO, for example in the cavity wall and solid wall supply chains.

Despite the best efforts of suppliers, there is a risk that CERT and CESP targets will not universally be achieved. In that event there is likely to be required a regulatory regime which respects actions taken in good faith in the context of the relevant Impact Assessments, that rewards the greatest efforts to compliance, and which does not impose a large cost on suppliers (which would eventually flow through to consumers).

Over and above the “housekeeping” matters such as timely administration, we believe that Ofgem can play a substantial role in enabling a sensible transition from CERT/CESP to ECO/GD, promoting efficiency measures to consumers, providing fora for best practice sharing, and for Local Authority and other stakeholder involvement.