

Maire Williams
Sustainable Energy Policy
9 Millbank
London
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12th September 2012

Dear Maire,

RE: Strengthening strategic and sustainability considerations in Ofgem decision making

We recognise that the industry faces some significant challenges in the medium to long term. The “tri-lemma” of securing sufficient energy supply, meeting our decarbonisation targets and ensuring energy costs remain affordable mean that the industry will need to take some vital decisions in the near future, potentially involving a lack of information and large elements of uncertainty.

We also recognise that Ofgem’s duties are relatively diverse and in some cases potentially contradictory. This in turn has the potential to lead to regulatory uncertainty, which can be damaging for consumers and industry stakeholders.

We agree therefore on the need for a robust and holistic approach to decision making, capable of assessing quantitative and qualitative considerations. We are therefore pleased to see Ofgem are taking this opportunity to review their approach to decision making.

Although Ofgem has a statutory duty to complete an Impact Assessment where their proposals will have a significant impact¹, we have not always seen a consistent or robust approach. During the Retail Market Review (RMR)² for example, we were concerned at the lack of any quantitative impact assessment for the proposals, when the proposals had significant impacts on customers, industry participants and competition more generally.

¹ Section 5a, Utilities Act (2000)

² As published on 23rd November 2011 (non-domestic) and 1st December 2011 (domestic).

It is therefore not only important to define *how* Ofgem will complete an Impact Assessment in the future, but also seek to define *when* they will consider an issue to have sufficient significance to warrant one. A robust, transparent, decision making process will provide industry stakeholders and investors with the certainty they need over how important change will be progressed; addressing the damaging uncertainty referred to above.

Transparency in this context also extends to the information Ofgem share with industry stakeholders. For example, Ofgem should take steps as part of this consultation process to set out the criteria GEMA³ will use to determine the weighting between the various elements of that Impact Assessment, how the Impact Assessment process will operate in practice and how industry stakeholders may interact with it. Transparency should also extend to any Cost Benefit Analysis produced as part of a decision itself. These should be published by Ofgem alongside any decision, with sufficient information for industry stakeholders to understand and replicate the calculations.

Although we broadly agree with the criteria Ofgem have set out for mid-term strategic and long-run sustainability considerations in the discussion paper, we believe that consideration of the overall impact of a decision on customer bills should be given more weight than is currently suggested. Customers tell us that their primary concern in the energy market today is the absolute level of their bills. It is therefore appropriate for Ofgem to give it equal prominence with mid-term and long-run sustainability considerations in any decision making process.

Wherever possible, we believe Ofgem should seek to use quantitative methods in their decision making process, even when considering the medium-term and long-run considerations. We recognise that this is often difficult, but our experience is that it is possible, particularly if scenario analysis and sensitivity testing are applied in order to produce a range of potential outcomes. We also believe that when using a quantitative approach, providing clarity and transparency about the underlying assumptions used is vital.

Where qualitative elements are required, it is important to consider both the potential range of impacts and the likelihood of those impacts arising under various scenarios. This will ensure that the results are interpreted as accurately as possible.

³ Paragraph 2.9 states that GEMA will ultimately determine the relative weightings.

We note that this is the start of a wider engagement process on this topic, and I look forward to contributing in the forthcoming workshop this Autumn. If you would like to discuss the issues raised in this response ahead of the workshop, please feel free to telephone me on 07789 570501.

Yours sincerely

David Watson

Head of Market Design & New Markets