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18 February 2015

Forward Work Programme 2015-16

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

Strategic Framework

EDF Energy supports Ofgem's adoption of an overriding strategic mission that *seeks to make a positive difference to energy consumers through independent regulation*. Setting a strategic framework that details critical priorities and outputs together with a forward work programme that shows how Ofgem's work will contribute to their achievement is a positive development, particularly in terms of transparency and predictability of regulatory activities.

We also agree with Ofgem that it is important that stakeholders are fully aware that independent regulation does not only involve setting and enforcing rules and regulations. Ofgem has a vitally important role in building trust and confidence in energy markets so that consumers engage, and ensuring its approach to regulating the market meets best regulation principles and creates an environment where new and existing companies are willing to invest.

CMA Market Investigation

It is important that Ofgem acknowledges the need for its forward work programme to be flexible in order that it can adapt to significant market challenges that may occur during the work programme period. The current market investigation by the CMA has the potential for significant and important market changes to be recommended that would likely have a significant impact on the forward work programmes and available resources for both Ofgem and industry participants. It is important therefore that in planning initiatives and setting deliverables for 2015-16 it is acknowledged that such programmes may be impacted by the need to direct resources to the development and implementation of any remedies recommended by the CMA.

We note that within the proposed work programme Ofgem confirms that in the context of the current market investigation it is unlikely to launch any major initiatives in 2015-16. We welcome this confirmation and believe it is a sensible approach given the uncertainties that exist in terms of future energy regulation policy. However, it is also possible that the range of regulatory framework developments contained within Ofgem's forward work programme may not be consistent with the CMA's views on the energy sector.

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We believe Ofgem has to be mindful of this risk and adapt its plans accordingly in order to reduce regulatory risk and avoid unnecessary costs being borne by the industry and ultimately consumers.

Trust and Confidence

We welcome the inclusion of 'trust and confidence' as one of the six strategic outputs Ofgem is seeking from its regulation of energy markets. EDF Energy has for sometime called for greater support from Ofgem in efforts to rebuild consumer trust in the energy sector. We are therefore pleased to see its prominence in the work programme acknowledging that Ofgem has an important role in restoring consumer trust and confidence.

We believe it is imperative that consumers are able to access robust (wherever possible based on reported numbers rather than estimates) and impartial information on energy costs and profits. We believe that an independent regulator should be best placed to source and provide such information. We therefore welcome Ofgem's desire to provide impartial and authoritative information to consumers and other key stakeholders. A good example of where the production of such information has brought benefits in terms of transparency is in respect of the development of the Consolidated Segmental Statements (CSS) over the past five years. Following improvements made in 2014, we note that Ofgem now consider that the statements are the most transparent since their introduction and present an accurate picture of profitability.

Supply Market Indicators

We remain concerned with Ofgem's Supply Market Indicators (SMI). While developments to the SMI methodology have been made over recent years, we continue to see large discrepancies in some of the underlying assumptions and the impact these have on the reported forward look of margins. We also note a recently published NERA report that independently reviewed Ofgem's SMI methodology and provided an assessment of Ofgem's analysis. NERA's report found that the SMI had repeatedly overstated profits compared to historical information released in the CSS. Over the period since 2009 NERA found that the SMI had exceeded the backward looking CSS margins by 50-200% on average. While acknowledging that improvements had been made to Ofgem's methodology, the report identified continuing systematic biases in Ofgem's approach that have led to their overstating of energy profits.

EDF Energy believes that consumer trust and consequently engagement, is impacted by profitability data that infers suppliers are making excess profits. We are therefore concerned about the detrimental impact the publication of the SMI, and the public narrative that is attached to the data, is having on consumer trust. We consider the provision of accurate cost movement and profitability data by influential stakeholders to be of vital importance in rebuilding trust and ensuring that consumers can and will engage with confidence. We are therefore disappointed to note that no mention of the SMI (review/development) has been made within Ofgem's work programme under its trust and confidence agenda.

REMIT implementation

We strongly support Ofgem working closely with ACER and other EU regulators in the application of REMIT. Such cooperation should over time facilitate the development by

Ofgem of an established understanding of how REMIT should be applied, monitored and enforced within the UK. In light of this, and in order to further promote compliance with the requirements, we consider that where possible Ofgem should seek to issue further guidance to market participants on the application of REMIT. Such guidance should not only reflect the outcomes of its cooperation with other regulators but also the results of its monitoring activities undertaken since the introduction of its REMIT powers.

Consequently, within Ofgem's work programme we would support the inclusion of further guidance development in this area.

High Standards of Outputs and Protection

Principle based Regulation

On a number of occasions Ofgem has publically expressed a desire to move away over time from extensive prescriptive regulation towards a greater reliance on principle based regulation (PBR) and a general principle of fairness. This was re-emphasised most recently by Dermot Nolan at Ofgem's Strategy Presentation on 22 January, where he made clear a desire for movement in this area "quite quickly". We urge Ofgem to give due consideration to the ways of reversing the recent trend of significant increases in prescriptive regulation, as witnessed in supply licences (an increase if over 380% in the last 5 years).

Given these comments we are somewhat surprised that no reference to moves to more PBR is made within the work programme. While we acknowledge that any significant moves in this area are likely to occur over the medium term we would have expected given Dermot Nolan's comments that some preparatory work would commence within the 2015-16 work programme e.g. on a decision framework, pre-requisites and licence review etc

Third Party Intermediaries

Under this theme we note that Ofgem will continue to take actions in order to protect the interests of consumers by giving them confidence that third party intermediaries will treat them in a fair, appropriate and transparent manner. This is an important piece of work and we continue to support the development of appropriate regulatory measures designed to meet this aim. In August 2014, Ofgem published its next steps in respect of its non-domestic TPI code of practice project which included an indicative timeline in respect of the next phases of this project. We note however that no explicit reference or any deliverables are included in the work programme. We believe that momentum needs to be maintained on this project in order to ensure that consumers' interests can best be protected and therefore support the inclusion of this projects deliverables within the Ofgem work programme.

Smarter Energy Markets Programme

We support measures designed to promote consumer engagement and empower consumers to make the right the decision for their individual needs. We see Ofgem's development of a smarter markets regulatory framework as an important development in achieving such aims whilst at the same time ensuring that there remains scope for market innovation to secure the relevant benefits.

The scope of reform that underpins this programme is vast and extensive including settlement, change of supplier, consumer empowerment and demand side response. We believe development of the foundations for the smarter markets regulatory framework is likely to be established over the next 12 months. Given the significance of this work, we are surprised at the minimal reference made to it within Ofgem's work programme, including the lack of any clear deliverables as set out in Annex 1.

Ofgem Budget & Spend

We note that Ofgem's planned expenditure from 2015-16 to 2019-20 is due to fall by only 0.6%. It is also noted that the current cost control regime of RPI-3% is due to finish in March 2015 with no indication of any extension or replacement scheme being put in place. Although any reduction in costs is to be welcome, we would question the degree to which Ofgem has demonstrated that its planned expenditure is based on 'challenging budgetary targets' given the small expected reduction in costs and the apparent lack of any imposed cost control regime.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact Steven Eye on 01452 653741, or myself.

I confirm that this letter may be published on Ofgem's website.

Yours sincerely,



Paul Delamare
Head of Customer Policy and Regulation