



taking care of the essentials

Ofgem's three year strategy 2004-2007 – letter of 1/9/2003

A Response by Centrica

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1. INTRODUCTION AND GENERAL COMMENTS

Centrica welcomes the opportunity to respond to Ofgem's letter in respect of its 'three year strategy 2004-2007'. Centrica has a keen interest in the development of the strategy and the interplay with energy, social, environmental and competition policy in the UK and EU energy market liberalisation.

Centrica is content for this response to be placed in the Ofgem library.

2. VIEWS SOUGHT

2.1. The key challenges you consider the industry faces in the short to medium term (for example, structural, social, environmental or technological)

Energy White Paper

A key challenge for the industry will be meeting the government's environmental targets and aspirations via increased energy efficiency, renewable and distributed generation, especially the potential growth of and need to accommodate micro-combined heat and power (domestic) and photovoltaic cells. This includes the industry response to various existing and future schemes, for example, Renewables Obligations, Energy Efficiency Commitment (EEC) and the future European Union emissions trading scheme.

European Union

There is a need to help to ensure the development of energy market liberalization in the EU member states is driven through whilst ensuring that UK market reforms are not undermined. Ofgem, in support of the DTI, needs to maintain a strong voice in helping to shape the European agenda, in assisting other regulators to implement liberalisation in their markets as well as continuing its constructive role of facilitating the implementation of European level policy. Appropriate incentives on monopoly infrastructure providers and transparent market mechanisms elsewhere should help to ensure adequate security of supply – while this is important for the UK, it can only be realized in a wider European context. Ofgem and the DTI need to ensure that more, and earlier, information is disseminated concerning the direction of European policy and the linkage of energy and environmental policy.

Social action

There will be ever increasing demands made for social action, in particular, increasingly challenging government targets with respect to removing fuel poverty. While progress is being made in this area on a number of fronts it is taking time to deliver the benefits. There may also be tensions between some areas of social policy and the environmental objectives of the Energy White Paper. For example, supplier obligations to target EEC action to help eradicate fuel poverty could increase overall fuel consumption as consumers take the "comfort dividend". Additional areas for policy consideration are likely to include customer debt assignment and disconnections.

BETTA

Successful implementation, though dependent on government time to implement the necessary primary legislation, will be a significant challenge in the light of the range of issues still to be addressed. At this early stage, it is difficult for players to make sound judgments about the potential impacts of any proposed changes. This understanding should increase as the policy options are developed in more detail. It is important to

produce a roadmap of associated areas to ensure that policy changes are implemented in the correct order and timeframe.

Supplier licensing regime

The current conditions of the gas and electricity supplier (and other) licences remain in essence as originally drafted for the beginning of the competitive gas market in 1995, even though there were some amendments at the introduction of the Utilities Act 2000. Under the Act, Ofgem gained significantly greater powers to take enforcement action and levy fines against breaches of licence that have only subsequently been set out in detail. This raises the wider question as what constitutes “compliance” in today’s market.

It would appear appropriate to undertake a holistic review of the Supply (and other) licences to ensure that they continue to drive appropriate supplier behaviour to deliver real consumer benefits, appropriate for the current competitive market environment. This requires a reassessment of the licences so that customers are protected by competition wherever possible and only by regulation where necessary as a safety net. In our view, the licences should ideally be recast to specify a set of behaviours or outcomes.

2.2. What action do you consider the Authority should take to respond to these challenges?

Prioritisation

In recent years Ofgem has not succeeded in completing its ambitiously planned workload within the given 12 month period. In 2002-2003 only 58 per cent of objectives were achieved on target. Though this was an increase from the 43 per cent achieved in the previous year, the number of activities delivered on time decreased by three as the number of planned activities had also reduced. The resources required to adequately address the key challenges highlighted earlier in this response are likely to be substantial. A further assessment of Ofgem’s prioritisation of activities is required to improve on past performance. There is also a need to recognise finite industry, as well as Ofgem, resource.

One suggestion could be the prioritisation of work along the lines of a ‘primary’ list and a ‘secondary’ list. The secondary list, which would be addressed where resources permit, would outline those activities that are additional to the key challenges that are planned on the basis of say 75 per cent resource utilisation for the relevant time period. A practical example is the following: if the substantial work required to facilitate Transco’s disposal of its LDZs goes ahead then a number of other activities are unlikely to be able to proceed.

Regulatory Impact Assessments

Centrica welcomes the recent commencement of Ofgem’s policy to carry out Regulatory Impact Assessments (RIAs) for all major changes though much more needs to be done to improve their usefulness. There needs to be greater compliance with the government’s guidance on RIAs. In particular, RIAs should contain: -

- The assumptions underlying the analysis;
- A range of costs and benefits highlighting the likely outcome(s), where the outcome is in doubt;
- The amount of cross subsidy, if any, being created or removed;

- The value being transferred, if any, between different industry groups; and
- Taking early soundings with potentially affected parties, for example via seminars and workshops, ahead of commencing work on key topics.

All major changes could also benefit from a post implementation review, along the lines of that recently proposed for network price controls. Such reviews would allow the actual benefits of the changes to be assessed against the original objectives and expectations. Over time RIAs would benefit from these reviews enabling the lessons learnt to be taken account of in future RIAs.

Consultation

Formal consultation documents have a necessary and valuable role to play in helping Ofgem shape and explain the regulatory and competition framework. However, Ofgem could improve policy development further by: -

- Providing early visibility of plans and work-streams together with more holistic “route maps”;
- Working more closely with the Department of Trade and Industry, the Department for Environment, Food and Rural Affairs, and participants in the energy industry to help meet targets set out in the Energy White Paper for example.
- Providing sufficient time and debate to consider major changes that affect the industry, for example the potential Transco LDZ disposals.

Ofgem could additionally enhance the process by publishing a matrix of typical consultation paths. That is, the document types, timescales and workshops that could normally be expected for: -

- A simple, non-material and non-contentious issue; through to
- Issues with material impact, complexity and contentiousness.

2.3. Are there new areas of work that, you believe, should be set in train and what degree of priority should they be given?

Renewables Obligations (High)

Work with the DTI to resolve the difficulties arising from the failure of TXU and Maverick with regards to their renewables obligation to ensure the market has confidence in the mechanisms.

Holistic review of supplier licensing arrangements (High)

See comments earlier in this response.

Security of supply arrangements and incident reporting (Medium to High)

The inadequacy of the current arrangements was highlighted by last winter's electricity distribution asset failures. A more rigorous system of reporting information from distributors to suppliers in respect of the large numbers of outages affecting suppliers' customers would help alleviate some of the problems that ensued.

Theft of electricity (Medium to High)

Since the introduction of the Utilities Act, theft of electricity obligations have been in place on the new licensed entities to reflect the split of distribution from supply. There are a somewhat confused set of incentives and obligations throughout the supply chain. Ofgem has previously indicated that this area would be subject to review and consultation. The industry again highlighted their concerns about the current arrangements as part of the recent Ofgem consultations on the review of electricity distributor incentives with respect to losses. Unless this area is addressed, any revised distributor losses incentives are unlikely to be effective.

Distribution Governance Arrangements (Medium)

Certain areas of the supply chain have flexible governance arrangements. A notable exception is electricity distribution. Though Ofgem has accepted the need for change, there are currently no plans in place in this area despite the opportunity presented by the current distribution price control review.

Force Majeure provisions (Medium)

There is currently a disparate set of arrangements throughout the industry with respect to Force Majeure. Even within electricity distribution there are different arrangements under DUoSAs, IIP incentives, Guaranteed Standards and Overall Standards. The need for differing arrangements is not clear and causes supplier and customer confusion.

2.4. Is there existing work that could be given greater or lesser priority or even stopped?

Customer Transfer Programme (Higher)

The industry has embarked on a comprehensive review of the energy transfer processes to ensure that switching is as easy and as efficient as possible. The potential improvements arising out of that review could have a significant impact in the way the transfer processes operate and are governed in the future. This will require the full commitment of the industry and Ofgem to address the challenges that will need to be resolved in order to realise the full benefits of the programme. Supporting initiatives such as the development of the Supply Point Administration Agreement (SPAA) will also require ongoing attention.

NGC Transmission Access and associated deep SO incentive scheme (Lower)

This area has been the subject of consultations over a significant period of time. Last year's (shallow) incentive scheme was rolled forward for one year in preparation for Transmission Access and an associated deep incentive scheme being introduced for National Grid from 1st April 2004. Clearly this is no longer a valid implementation date and the current incentive scheme is likely to be rolled forward once again. We suggest that, in light of these issues and timescales, and the forthcoming implementation of BETTA, it would be appropriate for these issues to be given a short term lower priority. We further believe that they should be completed either as part of, or subsequent to, the BETTA reforms. This would ensure that any new arrangements provided appropriate incentives across the whole of the electricity network in Great Britain.

Linepack services (Lesser or stopped)

The possibility of introducing market based linepack services has repeatedly been raised in consultations. The industry Review Group 513 process devoted considerable effort to this issue and concluded that such a service was likely to be costly, impractical and of limited application. We believe that the other areas highlighted elsewhere in this response merit a much higher priority by reason of the ultimate benefit that they may offer to customers. On this basis, it is our opinion that this topic should be removed from the list of active areas.

Proposed Storage Review (Stopped)

Given the recent Competition Commission Inquiry into the storage market following Centrica's acquisition of Rough, the planned Ofgem review of the storage market appears unnecessary. It would appear appropriate to include storage within Ofgem's ongoing work on wholesale market surveillance.

Tahir Majid/Regulatory Affairs/Centrica/ 10.10.2003