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Sent via e-mail to: chris.chapman@ofgem.gov.uk

Dear Chris,

Ofgem's proposed corporate strategy 2004-2007

Centrica compliments Ofgem for the consultation on its three year strategy in advance of the publication of the draft detailed corporate plan. We broadly support the seven key themes identified by Ofgem and the shifts in emphasis compared with previous years.

This response uses the headings contained in Ofgem's draft corporate strategy and we are happy for this non-confidential response to be placed in the Ofgem library.

2. Creating and sustaining competition

- 2.1 The objectives could be usefully extended to include the sentiment "Where competition is established, reliance should increasingly be placed on competitive pressures rather than regulation." With the notable exception of the removal of price controls, there has been a tendency to increase regulation to address identified deficiencies rather than review the continued requirement for the existing obligations in their current form.

We note that, although competition is well established in the retail and wholesale markets, this theme has, and will continue to, consume a significant proportion of Ofgem's resources.

Wholesale markets

- 2.2 We support the sentiments expressed by other respondents, namely that Ofgem should further reduce its role in this competitive area and look to remove unnecessary licence conditions. Ofgem's primary role in this area should increasingly be one of monitoring and ensuring ex-post compliance with licence and competition legislation.

Retail markets

- 2.10 It is relevant to state that the remaining price controls were relatively recently removed in March 2002. However, competition has been available to many domestic customers since 1996 and many industrial and commercial customers much earlier. Consequently we support the need to ensure, via an Ofgem review, that the current high burden of regulation is appropriate. A reduction in the regulatory burden is likely

to reduce unnecessary industry costs, reduce barriers to entry and exit and increase incentives for supplier innovation, leading to differentiation and customer benefit.

This potential reduction in unnecessary costs would be timely, as prices are not generally falling as they were in the past. The important twin objectives of meeting future environmental and social requirements are increasing upward pressures on prices. While protection of the fuel poor remains key, reducing regulatory burdens elsewhere would be beneficial for consumers more generally.

Industry structures

2.18 We support the continued work in this area.

Local gas distribution

2.19 We welcome Ofgem's confirmation (paragraph 1.2) that it will "only agree" to proposals to sell one or more gas distribution businesses "if they will bring real benefit to customers".

3. Regulating network monopolies

3.1 Though in principle we agree with the objective of aligning gas and electricity price controls for the whole of Great Britain and extending the gas distribution price control, care should be taken not to repeat the mistakes of the past. That is, when price controls are lengthened during (rather than prior to) the control period, companies can receive significant unwarranted windfalls (rather than strengthened incentives to efficiency). This "windfall" issue requires further consideration.

Incentives to invest

3.9 We recognise the issues associated with the potentially higher levels of transmission investment for renewables, the full costs of which were not included in the existing price controls. However, we are yet to be convinced that all the transmission price controls need to be reopened. Additionally, we have highlighted the potential asymmetry of the proposals (biased towards transmission companies), especially in light of the current approach used by the regulator Ofwat for the water industry.

3.10 We welcome the significant work being undertaken by Ofgem in relation to distributed generation incentives. However, we are concerned that the proposals do not appropriately balance the interests of electricity distribution companies and customers. For example, no justification has been provided for introducing incentives to connect distributed generation that are equivalent to providing relatively high rates of return even though this estimate is based on companies' own cost forecasts. Historically, companies' own capital expenditure forecasts have been significantly too high. Consequently, companies could be reasonably expected to earn very high rates of return.

4. Helping protect security of Britain's energy supplies

4.1 We would expect the poor performance of some electricity distribution networks during the storms of October 2002 and the subsequent need for Ofgem to determine customer compensation levels to be taken into account when company efficiency is assessed during the current electricity distribution price control review.

- 4.4 We support Ofgem's approach that reliance on competitive markets and investment incentives for network operators is the best way of ensuring security of supply.

Informing the debate

- 4.6 The JESS report in particular is a useful contribution to the security of supply debate. In general the latest report contains a number of useful improvements on previous reports. However, there are additional improvements that could be made both to the information provided in the report and the surrounding regulatory framework.

Making markets work

- 4.10 Although there are potentially additional improvements that can be made both to the regime and the information that is available to market participants, capacity payments to generators are unnecessary. Consequently, we support the principle of the combined approach of competitive wholesale and retail markets, appropriate incentive arrangements for network operators and the provision of appropriate information to market participants. We welcome Ofgem's reaffirmation that capacity payments are unnecessary to provide security of supply.

5. A leading voice in Europe

Influencing and shaping the debate

- 5.1 We support the increasing importance and scope attached to this area, particularly regarding cross-border transmission of gas and electricity.

6. Helping protect the environment

See our comments in the next section.

7. Helping tackle fuel poverty

Energy prices

- 7.5 There are upward pressures on prices partly as a consequence of rising commodity prices and partly as a result of meeting environmental objectives. Ofgem rightly recognises this. This upward pressure on prices could have adverse effects on the fuel poor but it is important that any mitigation of such pressure on this particular customer group is delivered in an efficient and targeted way.

Working with Government, industry and energywatch

- 7.8 There may be a tension between the desire to provide tariffs for vulnerable customer groups and the requirements of the Competition Act.
- 7.9 The effectiveness of the Government's funding of energy efficiency schemes to help reduce fuel poverty will be increasingly important.

8. Improving Ofgem's efficiency and effectiveness

8.2 Though Ofgem's costs remain small in comparison to total industry costs there remains a strong case for ensuring that they are as low as possible. We would suggest a refocusing along the lines of the seven themes and would hope this is addressed in the plan.

8.6 The recent use of RIAs has been a welcome development, though we agree with Ofgem that there is scope for their improvement. Generally, transparency of Ofgem's decision making has been good or improving. However, Ofgem has made some important decisions in relation to amending company price controls with very little consultation, the absence of a discussion of alternatives and without RIAs.

8.7 We welcome Ofgem's desire to look afresh at its priorities.

If you have any questions about any aspect of this response, please do not hesitate to contact me on the number given above.

Yours sincerely

Tahir Majid
Regulatory Issues Manger, Strategy