



taking care of the essentials

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## **Ofgem's three year strategy 2005-8 – letter of 5/8/2004**

### ***A Response by Centrica***

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Author : Tahir Majid  
Document ref : H:\regulatory affairs\raffairs\tahir  
Version No : 1-0  
Status : Final  
Issuing Authority : Regulatory Affairs  
Date Issued : 01/10/2004

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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 2005-2008'. Centrica has a keen interest in the development of the strategy and, in particular, the assessment of the relative priorities, inter-relationships and trade-offs between the policy objectives.

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

## 2. VIEWS SOUGHT

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

"The action you consider the Authority should take to respond to these challenges"

"The priority of work that you think we should tackle, in response to the challenges you identify"

The following section details Centrica's response to the questions posed by Ofgem. The order of the response indicates our view of the relative priority of the issues.

### 2.1

#### **Challenge**

##### Security of supply, functioning of UK wholesale energy markets and Europe

Recent events and forward projections have highlighted the importance and interdependence of security of supply, the functioning of UK wholesale energy markets and continental European market liberalisation. These issues will remain key in the short to medium term and probably beyond.

The tightening of supply/demand in gas has resulted from a faster than expected decline of supplies from the UK continental shelf. This will necessitate an increasing reliance on relatively higher priced supplies from continental European countries and non-European LNG imports which are impacting on both gas and electricity prices, although price levels appear to be higher than market fundamentals would suggest. Consequently, we support Ofgem's investigations in this area. This needs to be a key area of focus over the period of the strategy.

The slow introduction of competition in certain Continental European markets tends to favour the incumbent energy suppliers. The lack of fully competitive retail and wholesale energy markets and access to cross-border transportation leads to distortions which we believe are having an effect on the UK market, both in terms of wholesale prices and potentially UK security of supply.

#### **Action**

##### Transparency in offshore gas markets

Transparency should be improved to ensure prices reflect the near term supply/demand balance, in particular:

- Current information on forecast gas production capacity, expected production levels and near real-time actual production is not disclosed to all market participants. This situation contrasts sharply with the UK electricity market;

- Currently there is no real-time monitoring of behaviour in the traded energy market. The Financial Services Authority could be given jurisdiction to monitor internet trading platforms in real time, as with the International Petroleum Exchange.

#### Delivery of gas import projects and supplies

Ensure that the market is able to deliver security of supply via timely completion of new gas import projects:

- DTI and Ofgem should work together to develop a clear and efficient legal and regulatory framework in which investment decisions can be made;
- UK infrastructure should be enhanced where necessary to ensure sufficient gas entry capacity is available;
- Harmonisation and interoperability issues need to be addressed.

#### European liberalisation

Ofgem should maintain pressure through ERGEG and CEER with the European Commission to ensure the full and effective liberalisation of the European gas and electricity markets, as quickly as possible, including:

- Full and rapid implementation of EC Directives in gas and electricity;
- Requirement of transmission, distribution & storage operators not to discriminate between users;
- Removal of unnecessary tax and administrative barriers to interconnection and cross border trades;
- Development of new gas, power and capacity release programmes in Continental Europe and extension of existing ones where there is insufficient competition;
- Effective consumer choice of supplier and efficient switching processes;
- Resisting regulation that threatens to undermine competition.

## 2.2

### **Challenge**

#### Environmental

A key challenge for the industry for the foreseeable future remains meeting the government's environmental targets and aspirations whilst ensuring that the energy sector is not set disproportionately high environmental targets by government leading to unreasonable increases in customer costs.

Delivering future environmental improvements at any cost will lead to customers bearing an inappropriate burden. Recent examples of less than successful policies have included the transmission cross subsidies for Scottish remote renewables generators and the proposed arrangements for distributed generation for electricity distributors as part of their revised price control arrangements.

## **Action**

It will be important to continue to ensure that environmental improvements are brought forward by encouraging the use of market mechanisms where appropriate, by removing unnecessary barriers to their development, encouraging efficiency of operation and most importantly, in line with a key theme of the Government's energy white paper, only introducing them if they are affordable. Consequently, it will be important to review EEC2 at an early stage of its life because of the risk of high cost delivery.

In the longer term a better balance needs to be struck between the existing objectives and aspirations in the energy sector and the potential environmental improvements that could be achieved, for example in the transport sector generally and aviation in particular. The future potential of nuclear power needs further consideration. Against this background, Ofgem needs to help ensure that the government does not set disproportionately high environmental targets and costs for the energy sector.

## 2.3

### **Challenge**

#### UK competitive domestic supply market maturity

In our view, the evidence presented in Ofgem's recent report clearly illustrated market maturity. Based on the evidence in the review, competition continues to benefit customers in the domestic supply market with awareness levels high and customer dissatisfaction levels remaining low. Consequently, we believe Ofgem's conclusions to the contrary appear unfounded.

The current gas and electricity supplier obligations remain in essence the same as those that existed prior to the introduction of competition.

In light of the above the existing regulatory framework is overly prescriptive, stifles further innovation and hence is not does not maximise customer welfare.

### **Action**

#### Holistic review

Ofgem should firmly commit to undertake a holistic review of the broader regulatory framework relevant to supply to ensure that it continues to drive appropriate supplier behaviour to deliver real consumer benefits commensurate with a mature supply market. This requires a broad reassessment of the regime so that customers are protected by competition wherever possible and only by energy specific regulation, as opposed to general consumer protection legislation, where demonstrably necessary, i.e. to adopt a lighter touch regulatory framework. In particular Ofgem should:

- Set out a clear process and next steps;
- Advocate a 'blank sheet' approach;
- Accept that any proposed changes under the review would probably not be finalised until 2007 and may need to be introduced on a phased basis, for example, by moving to a light touch regulatory framework for the majority of customers whilst perhaps temporarily leaving in place additional obligations for disadvantaged groups; and

- Engage in constant dialogue throughout so that there are no surprises, for example via seminars, consultations, working groups, i.e. a fully inclusive process.

Overly prescriptive regulation can have unintended consequences, whereas self and co-regulation can deliver cheaper and more flexible business/regulatory practices. Ensure that incentives are there to encourage this development.

### Customer Transfer Programme

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 continuing full commitment of the industry and Ofgem to address the challenges that will need to be resolved in order to fully realise the significant benefits of the programme.

The customer transfer programme and the DTI review “Extending Competitive Markets: Empowered Consumers, Successful Business” should help to support and underpin the fundamental supply review.

## 2.4

### **Challenge**

#### Ofgem's priorities and trade-offs

As part of the last strategy and planning process there was a recognition from Ofgem of the increasing demands for social action and the tensions with the environmental objectives of the Government's Energy White Paper. This tension has been heightened by the recent significant rise in wholesale energy prices, compounded by increases arising from environmental pressures – EEC, renewables, and ETS, which will increase the number of customers in fuel poverty, reversing the downward trend over recent years. There are some important trade-offs in the relative priorities of these potentially conflicting policy objectives which would merit serious discussion in Ofgem's strategic plan.

There is a more general point regarding how Ofgem assesses and prioritises its strategic objectives and linked to this is the need for a much more holistic approach to addressing strategic choices which impact on each other as discussed above and earlier in relation to security of supply, wholesale prices, and Europe.

It is still not clear why certain areas of work proceed ahead of others.

### **Action**

#### Joined-up thinking

There needs to be clarity underpinning Ofgem's strategy formulation on how, and to what extent, linked or conflicting priorities can be met both in the near term and over time. While the focus must be to continue to rely on market forces to deliver the benefits of competition to all consumers, a strategy on how best to reconcile the fuel poverty issue would be particularly valuable.

### Customer benefit

Though Regulatory Impact Assessments (RIAs) are now routinely carried out for all major work carried out by Ofgem, they are currently only used once a particular project has been given the go ahead. RIAs should be introduced at the strategic level and as an integral part of the Ofgem strategy and planning process so that priority is given to those areas of policy which maximise consumer benefit. Such an approach would provide a clear rationale for the priorities to be given to the main “themes” and the resource allocation to support the delivery of the strategy.

**Tahir Majid/Regulatory Affairs/Centrica/ 01.10.2004**