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## **Ofgem Proposed Corporate Strategy and Plan 2005-10**

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

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## 1. INTRODUCTION

Centrica welcomes the opportunity to respond to Ofgem's proposals for its Corporate Strategy and Plan over the next five years to 2010. We are happy for this non-confidential response to be placed in the Ofgem library.

Centrica broadly supports the seven key themes identified by Ofgem and the shift in emphasis when compared to the previous plan. We particularly welcome:

- a) the emphasis Ofgem is placing on Europe and recognition of the importance that the liberalisation of European markets has on protecting Britain's own energy supplies; and
- b) the intention, as reflected in the supply licence review, to reduce the regulatory burden on suppliers.

Centrica's response to the draft strategy and plan addresses the following topics:

- a) the overall structure and framework of the draft strategy and plan;
- b) the competitiveness of the UK energy market; and
- c) the refocus on Europe.

We conclude with some brief remarks on the appeals mechanism and the resource commitment with respect to the environmental theme.

## 2. GENERAL COMMENTS ON STRUCTURE AND FRAMEWORK

### 2.1 Structure

In its broadest sense we believe the framework within which Ofgem's strategy and plan should be developed is relatively straightforward. Firstly, the plan needs to review the current state of the energy markets and provide a vision of how this environment is set to develop over the period of the plan; from this the key challenges facing the industry may be deduced. Secondly, Ofgem should then present the key objectives and work plan proposed to meet these challenges and the level of resource needed to implement the work plan. An essential element of the plan should be a clear explanation of the interrelationships between:

- a) Ofgem's objectives;
- b) how these have been prioritised, and
- c) how the particular resource allocation has been determined.

We do not believe that the current proposed plan fully accomplishes this. Accordingly, whilst we recognise the time constraints for wholesale changes to this plan, we offer Ofgem the following thoughts and suggestions which, if they cannot be adopted now, may help inform the development of Ofgem's future plans.

### 2.2 Total Resources

Ofgem's plan adopts an RPI-X regime committed to reducing costs by 3% per annum or by £5.3m in real terms over the plan period. Whilst we commend Ofgem for this commitment to control costs, we observe that the draft plan contains no analysis about

how the proposed 3% reduction in budget strikes the right balance between reducing costs and delivering customer benefit. Our view is that the plan could be enhanced by the inclusion of such analysis.

We also note that under the proposed RPI – X regime increasingly scarce resources will have to be managed by either increasing efficiency, i.e. committing fewer resources to the same level of activities or by reducing the range of work areas undertaken.

Therefore we would expect to see in the plan where Ofgem believes it can deliver efficiency savings and where Ofgem anticipates withdrawing from work areas, i.e. a redefinition of Ofgem's tasks. For example, whilst it is accepted that a successful review of the supply licence will allow Ofgem to withdraw from detailed regulation of the retail sector, the plan does not quantify the impact that this important initiative will have on Ofgem's resource requirements over the period of the plan. We believe that future plans would be enhanced by this type of analysis.

Recommendation: Ofgem should explain its methodology for the allocation of resources for each theme on the basis of benefit for consumers and demonstrate that the correct level of resource has been allocated to achieve the relevant objectives.

### **2.3 Year on Year Variation**

We recognise that whilst the overall budget for 2005 is broadly similar to 2004, this similarity masks significant variations in theme resources between 2004 and 2005. For example, the budget for 'Leading voice in Europe' has increased from £860k to £2,123k, whereas the budget for DN sales has reduced from £1.72m to £497k. We believe that Ofgem should provide details of the year to year variation, i.e. change in priority as determined by benefit to consumers, withdrawal from regulation or a change in regulatory involvement in major projects.

For instance, with respect to Europe, we believe that Ofgem should set out the rationale behind the additional resources and explain the value to UK consumers represented by that resource allocation. Similarly, with respect to the DN sales, we would expect to see that Ofgem's proposed budget reduction still allows sufficient resources to complete the considerable level of activity planned for 2005.

Recommendation: Expand Appendix 3 to include previous year's spend, variance from the previous year and the rationale for that variance.

### **2.4 Transparent Prioritisation**

Ofgem has presented the plan under the seven themes identified in last year's Corporate Strategy. Whilst the advantage of continuity over time is clear, Ofgem should do more to demonstrate that the plan has been constructed using joined up thinking and that it is not simply a compilation built up from the seven themes. One of the disadvantages of the existing approach is that the prioritisation among, and within, the seven themes and the rationale behind the allocation of resources is opaque.

A more transparent prioritisation would enable Ofgem to refine its list of deliverables, to focus on what will bring the greater benefit to consumers over the next five years, and to set out a clearer road map as to how those deliverables will be achieved.

We are also concerned that the majority of the deliverables appear to focus on electricity; Ofgem must ensure an appropriate balance between gas and electricity.

Recommendation: Ofgem should provide details of the assumptions and conclusions which lie behind the ranking of themes as well as the individual projects that make up the themes, and how the resource allocation links to consumer benefit.

## **2.5 Strategy and Plan Timeframe**

We note that the five year strategy is only accompanied by a one year plan. Whilst we acknowledge that there will be greater detail provided for the coming years and that the further out in time the plan extends, the greater the uncertainty, we believe that Ofgem should be in a position to present both the strategy and plan over a five year period.

## **3. COMPETITIVENESS OF THE UK ENERGY MARKET AND EUROPE/SECURITY OF SUPPLY**

We believe that the two highest priority themes in terms of benefit to the consumer are the competitiveness of the GB energy market and Europe / security of supply. We offer the following comments on those two themes.

### **3.1 Competitiveness of the UK energy market**

As we stated in our previous response, it is our view that the evidence presented in Ofgem's April 2004 Competitive Market Review report clearly illustrated the competitiveness of the energy market. Based on the evidence in that review, competition continues to benefit customers in the domestic supply market. Awareness of competition is high and customer dissatisfaction levels remain low. Customer switching levels have remained very strong, particularly following price rises, indicating that the market is working effectively.

We also believe that the competitive energy market is increasingly mature. Suppliers respond positively and strongly when faced with customer issues, without the need for regulatory intervention. This is exemplified by the industry working together to improve business practices for customers transferring between suppliers and to improve the protection for the more vulnerable customers of our society.

Suppliers are also demonstrating an increasing reliance upon self and co regulatory initiatives with examples including:

- the development of the Code of Practice for Face to Face Sales
- the direct action by suppliers, like British Gas, to immediately suspend forcing entry to customers' homes to disconnect supplies in the light of the 'Bates' case; and
- the implementation of enhanced measures to protect the interests of vulnerable customers.

In our view, commensurate with this increasing degree of maturity and competitiveness, we would expect to see a lighter touch to the energy market regulatory environment.

However, instead of a lighter touch, we have seen some evidence to the contrary. In some cases, the additional regulatory intervention has not ways been fully justified or well founded. An example of is the introduction of suppliers' Standards of Performance. The introduction of those standards was predicated upon an unjustified perception that the development of metering competition would leave customers exposed. No impact assessment was undertaken to provide the justification for this decision.

It is against this backcloth that we welcome the recent supply licence review consultation. The current gas and electricity supplier obligations remain essentially the same as those that existed prior to the introduction of competition (with the exception of lifting price controls). This review will provide the opportunity for Ofgem to demonstrate its commitment to lighter touch regulation within competitive markets through aligning the regulatory requirements and obligations to reflect better the competitiveness of the market. In particular we welcome Ofgem's intention to use the Better Regulation principles which require full justification for any regulation over and above general consumer law.

The supply licence review is a significant initiative and we offer the following initial comments in advance of responding formally to the February consultation:

- With respect to the Ofgem timetable for the completion of the review, our assessment is that the 24 month option is more realistic than the 12 month option;
- The issue of vulnerable customers should be addressed as part of this review and not as part of a separate consultation. This will ensure that there is no prejudgement of the outcome of the licence review; and
- The review should not be frustrated and / or limited due to other licences or regulations being out of scope. For example, where there are dependencies with secondary legislation, the gas shipper licence, the electricity generation licence and industry codes, or any other related licences, etc, these should be included as part of the review.

### **3.2 Europe / Security of Supply**

We are greatly encouraged by Ofgem's approach detailed in section 6 'A leading voice in Europe', which in broad terms proposes to :

- engage closely with other EU regulators;
- influence progress towards liberalisation to the benefit of GB consumers;
- work to bring about reforms within the EU to enhance competition in European gas markets; and
- promote a better regulation agenda at the European level.

As Ofgem is aware, the shift in the GB gas position from net exporter to net importer has significant implications for this country's dependency on foreign supplies and therefore it is essential that the institutional and regulatory impediments to gas flowing across the European continent are removed. We believe that this can only be realistically achieved by Member States embracing the Energy Directives and delivering competitive energy

markets which are transparent and independently regulated.

For this reason, we believe that the liberalisation of the European energy markets probably constitutes the single most important challenge for Ofgem over this plan period, and thus Ofgem needs to state real goals with tangible, 'SMART' deliverables, supported where possible by performance indicators.

We would note that there are two dimensions to Ofgem's responsibilities in this area – not only to work at a European level to safeguard the interests of Great Britain, but also to play its part as a leading European energy regulator in ERGEG / CEER in supporting the effective implementation across and within member states of EU Directives aimed at securing effective competition. We are pleased to see that Ofgem will be arguing for relevant EU legislation to complement, and not to hinder, the development of effectively competitive markets.

In our previous response we listed some key critical success factors we consider to be necessary to achieve effective competition in European energy markets, and thus protect the interests of British consumers. We suggest that Ofgem should consider reflecting these in its European deliverables and performance indicators, on the lines of the following:

- ensure the full and timely implementation of EC Energy Directives and Regulations in gas and electricity, including:
  - no delay to the 1<sup>st</sup> July 2007 deadline for full market opening;
  - effective unbundling regime;
  - non-discrimination between users in the provision of transmission, distribution and storage services; and
  - effective consumer choice of supplier and efficient switching processes (to share best practice within CEER).
- ensure that new EU legislation does not undermine competition and GB market arrangements, for both electricity and gas;
- ensure non-discriminatory access to unbundled gas pipes and fair and non-discriminatory allocation of capacity to secure supplies of piped gas and LNG both from within and outside the EU;
- follow through on Madrid Forum conclusions, in particular in relation to calculation of available capacities, transparency of flow information and ensuring non-discriminatory access to transit routes as well as within-country transmission;
- set out guidelines for improving balancing markets via the CEER (ensuring that there is a goal of market-based balancing and that until this is achieved monopoly balancing services must be based on efficiently incurred costs);
- secure the removal of unnecessary tax and administrative barriers to interconnection and cross border trades;
- secure new gas, power and capacity release programmes in Continental Europe and extension of existing ones where there is insufficient competition; and

- ensure that network users are included in the 'mini-fora' set up to examine the way congestion at borders is managed.

In the recent speeches made by the European Commissioners Kroes and Piebalgs, a joint inquiry into the European energy market by DG Competition and DG Energy was specifically mentioned. We welcome this inquiry and strongly support the resource commitment that Ofgem is making to this effort. Ofgem's experience regarding the liberalisation of the GB energy market will be an important resource for the DGCMP energy market review.

In addition, we believe that Ofgem should make reference to the anticipated increased workload resulting from the devolvement of Articles 81 and 82 from the EU Commission to the national authorities and provide assurance that it will act consistently and in accordance with guidelines when applying UK and / or EU competition law.

## **4. OTHER ISSUES**

### **4.1 Appeals Mechanism**

One of the participants at the February Strategy and Plan seminar suggested that the GEMA meetings, at which code modification decisions are discussed, should be open to the public. We support the need for greater transparency in this area. In our view greater transparency regarding GEMA decisions in respect of code modifications will enhance the efficient and effective utilisation of the appeals mechanisation introduced by the Energy Act 2004.

### **4.2 Environment**

Ofgem is already involved in environmental issues, specifically EEC and the renewables obligation. Ofgem has also stated that it intends to conduct a review of the EU ETS and to bring further environment related work in house. In addition the Government is currently consulting on its Climate Change Programme review, and the EU is discussing an Energy Services Directive. All these factors indicate a further resource requirement by Ofgem in this area. The plan should reflect the anticipated additional need for this.

**Roddy Monroe/Regulatory Affairs/Centrica/ 04.03.2005**