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Date: 27 February 06

Dear Andrew

Ofgem's Proposed Corporate Strategy and Plan 2006-2011

We welcome the opportunity to provide comments on the above document. Our overall comments are set out below, while the attached appendix provides a response to the consultation questions followed by detailed comments on each of Ofgem's strategic themes in turn.

<u>Ofgem's Priorities</u>
We support the seven themes of Ofgem's regulatory strategy and consider that the priorities for 2006/07 include:

- Developments to combat fuel poverty;
- Building on existing work in Europe to promote the interests of UK consumers;
- Continued integration of environmental work with other regulatory themes responding, in particular, to the outcome of the Energy Review later this year;
- The transmission and gas distribution price control reviews including the development of mechanisms such as "TIRG" to cater for the considerable uncertainties in investment needs; and
- Work to resolve issues in the wholesale gas markets.

<u>Costs</u>
We continue to have strong concerns about Ofgem's high level of costs and staff numbers (static at 291 in both 2003/04 and 2004/05 annual reports), compared to equivalent figures for energy regulation in the mid 1990s. Essentially, we believe that less regulatory resource is needed to oversee competitive markets and also in some aspects of network regulation.

We welcome the RPI-3 cost control undertaking and the other deregulatory initiatives that Ofgem has announced, such as those associated with Project Paperless. These should all contribute to a downward pressure on Ofgem's costs. However, we have some concerns that areas Ofgem has designated as being "outside the RPI-3 cost control regime" are tending to increase headline costs to licence holders. We would like to see greater transparency on these costs and the outlook for them coupled with actual reductions in licence fees from year to year according to the expectations set by the RPI-3 control.

Unnecessary Areas of Work

Despite the incentives of the RPI-3 control, we note that there are some areas where Ofgem appears to be expanding its workload. Examples of these include the development of the commercial governance arrangements in electricity distribution (the “DCUSC”); the development of electricity distribution charge structure; and the development of complex incentive mechanisms in gas transmission. In all of these areas, we believe that Ofgem could reduce its own workload and therefore both the direct and indirect costs it imposes on the industry.

Regulatory Stability

We strongly believe that there is value in regulatory stability, backed by industry-governed processes to initiate change where it is really required. In this vision, Ofgem would take a more reactive role, intervening only when industry processes had not resulted in consensus. As well as active consideration of options for deregulation, which we acknowledge that Ofgem now appears to be addressing, an important part of Ofgem’s agenda should be to seek to reduce the quantum of change that was to be introduced at any one time for any class of market participant. An important part of this approach would be for Ofgem to control the number of consultations that are open at any one time.

I hope these comments and the attached appendix of detailed points are helpful.

Yours sincerely

Rob McDonald
Director of Regulation

APPENDIX

Ofgem's Proposed Corporate Strategy and Plan 2006-2011
Response to Consultation Questions and Comments on Detailed Points

Consultation Questions

Question 1: Do the themes remain valid?
Yes.

Question 2: Have we identified all the relevant issues within each theme?
Yes.

Question 3: Is Ofgem's approach to the challenges ahead the right one?
We do have comments on Ofgem's proposed approach in some areas and discuss this, where appropriate, in our detailed comments on each theme below.

Question 4: Are there any licence conditions or other obligations that impose an unnecessary administrative burden?
In our view, there are a number of areas where the regulatory burden could be reduced and we set these out at the end of this appendix.

Creating and Sustaining Competition

Wholesale Gas Prices
Given the continuing high and volatile prices in the wholesale gas market, this should clearly remain a key priority for Ofgem over the next year or so. We fully support Ofgem's work over the previous winter, particularly in relation to lobbying the EU Commission to ensure compliance with the market opening directives and in the meantime to see that better information is made available about gas flows on the continent. We are also fully supportive of Ofgem's efforts to ensure that better information is made available about the UK offshore market. However, given the present lack of transparency about the offshore market, we would question whether further measures are also necessary, such as a more formal investigation of the offshore trading arrangements.

Retail Competition
We welcome the suggestion that Ofgem will "look to rely on self-regulation or general competition and consumer protection law wherever possible". We have long maintained that, where competition has become established – such as in retail energy markets - Ofgem should withdraw from regulation and drastically reduce the considerable resources it is using for monitoring, enforcement and compliance. However, the tentative initiatives in this direction are qualified by other statements that energy markets are different from other commodity and service industry markets. We dispute that this is the case and Ofgem provides no further evidence in support of this assertion.

We firmly believe that Ofgem should set a long-term objective to remove all sector-specific regulation of the energy retail markets. In practice, this would mean that licence conditions should only be required where there are genuine differences in the energy market compared to other competitive markets (e.g. because of interoperability of the transfer process) or where there is proven market failure. At the very least, Ofgem should seek to remove all licence conditions which mirror or replicate wider economy-wide consumer protection legislation (as Ofgem has done most recently in the case of regulating telesales).

We therefore welcome and are actively supporting Ofgem's project to review the supply licences, with a view to developing a simpler set of licence obligations. We are taking an active role in this work and look forward to seeing the results of the project later in this calendar year. We firmly believe that the licence review should result in a substantial reduction in the scale and scope of the energy supply licences. However, we would be disappointed if any deregulation was made conditional on increased self-regulatory initiatives, which can be just as costly to suppliers as direct Ofgem or Government intervention.

Regulation of Wholesale Markets

Following completion of the energy supply licence review, we believe that Ofgem should embark on a separate project to assess whether similar scope exists to reduce Ofgem's involvement in the operation of the wholesale energy markets, particularly electricity. For example, now that NETA and BETTA have been successfully implemented, we would question whether it is necessary for Ofgem to continue to approve or reject all changes to the industry codes.

Transmission Constraints

We are concerned to note the reference to the management of transmission network constraints in Scotland under the heading of energy markets. British-wide wholesale electricity and transmission arrangements were established on 1 April 2005, after a detailed project to deliver all the necessary legislative and contractual arrangements. SSE played its part in developing those arrangements and one key area for us was the establishment of the split of responsibilities between the transmission system operator (SO), National Grid, and the transmission asset owners (TOs), which in Scotland are the transmission licensees within SSE and ScottishPower. Network constraints was clearly identified as an issue for TOs to manage in consultation with the SO, rather than an area for market development. Furthermore, now that a GB market has been established, it would be unacceptable for generators in Scotland to be treated differently to their counterparts in England and Wales with respect to constraints. We do not therefore believe that transmission constraints in Scotland warrant a separate piece of work by Ofgem.

Metering

We welcome Ofgem's consultation on the theme of innovation in metering and the acknowledgement that, where there has been successful roll-out of smart metering technology in Europe and North America, it has been achieved on the basis of a regulated product rather than left to the competitive supply markets. We have an active interest in this area and have written previously with proposals for such a trial of innovative metering technology in one of our distribution services areas. We would urge Ofgem to provide regulatory approval for such a trial as an early outcome from this area of work.

Markets for New Generation

As a final observation on this section, we would comment that there is very little discussion of developments in the market for new generation. We find this surprising, given the comments, in the section on security of supply, on the need for significant new investment in this sector as existing coal and nuclear capacity comes to the end of its operating life. In our view, stability and consistency of network charging arrangements and transmission losses will be particularly relevant for this market. In this regard, we remain concerned that the current charging regime in transmission is a significant barrier to investment in the north of England and Scotland. We continue to believe that the new transmission use of system charges that were introduced as part of BETTA result in a punitive locational signal that is not reflective of the underlying costs of the transmission system. We would therefore urge Ofgem to complete the promised review of transmission charges, which was a condition of approval of NGC's charging methodology.

Regulating Network Monopolies
We recognise that regulating monopolies is a fundamental strand of Ofgem's work.

Incentive Regulation
In general, we support Ofgem's commitment to incentive regulation in developing the price control framework for regulated monopolies. In particular, we believe there should be a sharpening of incentives on frontier companies to out-perform regulatory expectations. The final proposals for the electricity distribution price control review stated that the matter of an operating cost rolling incentive scheme may be considered further during the current period and we would encourage Ofgem to address this issue in the near future.

We also support the development of schemes to incentivise innovation, such as the innovation funding (IFI) and associated incentives in electricity distribution and potentially a similar approach for metering innovation. However, we do consider that incentives should be as simple as possible. We would therefore argue that the continuing reviews Ofgem proposes for quality of service incentives should, in electricity, concentrate on simplifying the complexity of existing arrangements. Similarly, we believe the transmission system operator incentives are extremely complex, and simplification would also be welcome as these fall to be reviewed.

Gas Network Incentives
In relation to network incentives in the gas market, we note that Ofgem intends to introduce incentives on the distribution networks (DNs) to purchase an efficient level of gas transmission capacity. This is directly linked to Ofgem's proposed reform of exit capacity arrangements for the national transmission system (NTS) about which we have significant concerns. In particular, Ofgem's proposed model is based upon the NTS entry capacity auction regime which, in our view, has failed to reveal long term investment signals to the NTS and has added significant complexity and risk to the gas wholesale market. It is also accompanied by extremely complex and opaque NTS incentive arrangements. On this basis alone, we do not believe that it is appropriate to mirror these arrangements at exit.

However, it is also apparent that NTS exit arrangements are far more complex than NTS entry arrangements as they involve both purely commercial organisations (shippers and direct connects) as well as DNs who have far reaching obligations associated with meeting their statutory and operational requirements. Whilst we fully support Ofgem's desire to introduce incentives on both NTS and DNs in respect of investment in their own systems, we firmly believe that this can be achieved relatively simply by making appropriate enhancements to the existing planning and operational procedures coupled with transparent and simple output-based incentive schemes.

In relation to quality of service incentives, we are actively working with Ofgem to further develop gas reporting systems in this area. However, we do not believe that an incentive regime that replicates the quality of supply arrangements in electricity is appropriate, as the nature of supply interruptions in gas is different (i.e. the majority of interruptions in gas are planned and tend to be of longer duration). It is for consideration whether expansion of the existing customer survey, for example, would be preferable.

Network Price Controls

We recognise that much of Ofgem's work within this regulatory theme will be concerned with the price control reviews that are due to conclude in the next few years. On this topic, we welcome Ofgem's commitment to further assessments of its approach to setting price controls, with the intention of developing greater certainty and a stable long-term framework for these businesses.

Transmission Price Control Review (TPCR)

In the TPCR, it is apparent that a step change in investment driven by new renewable generation in electricity and change to net import requirements for gas will be required. It is important to maintain incentives on licensees but also important to deal with the uncertainty regarding the timing and level of investment. Very large investments are required to accommodate these developments but the scale and timing remain uncertain.

For both electricity and gas, we believe that a development of the "TIRG mechanism" (transmission investment for renewable generation), put in place for the interim extension to the electricity transmission controls in Scotland, should be used going forward. This development would involve early identification of the major investments required to reinforce particular parts of the network, together with the appropriate trigger points when the particular investment would become necessary and efficient. This would then automatically release the funding for the project without the need for price control re-openers.

We continue to believe that this mechanism is simple, transparent and retains the usual incentive properties of RPI-X regulation. By contrast, alternative approaches involving "automatic" adjustments to allowed revenue via, for example, revenue drivers and/or auctions of capacity tend to be overly complex (leading to unintended consequences), difficult to set in advance and can produce inappropriate incentives (e.g. to delay investment). We note the reservations expressed in the second consultation paper on the transmission review but, for the reasons outlined above, urge Ofgem not to rule out from the outset using a TIRG approach in the new transmission controls.

Structure of Charges Developments

We have commented for some years now on our concerns about the continuing and wide-ranging reviews of use of system charges. Such reviews create non-optional costs for industry participants in responding to consultations and attending workgroups relating to the development of regulatory policy in these areas. In addition, extended periods of uncertainty arise for those liable to pay use of system charges and indeed, very significant disturbances in liability for use of system charges for individual market participants can result from these reviews. We have seen this uncertainty extending over several years in electricity and gas transmission and are concerned that Ofgem are promoting the adoption of similar charging approaches in electricity distribution.

Indeed, we fail to see the locus for Ofgem's involvement in promoting particular types of charging methodology. In electricity distribution, we now have a set of licence conditions on the production of charges and charging methodologies, which clearly envisage a role for DNOs in reviewing and proposing modifications to charging methodologies and a role for Ofgem in approving or vetoing any such proposed modifications. Instead of developments proceeding under this anticipated framework, we seem to be moving towards a situation where Ofgem is being prescriptive about the types of changes that it requires to be made to the charging methodologies without a clear basis for its powers to do so.

In addition, we consider that there are several problems with long run marginal cost (LRMC) based charging that Ofgem wishes to see in electricity distribution:

- The cost of developing, populating and maintaining such models is significant. Any required billing system changes for DNOs would also affect suppliers. There has been no adequate regulatory impact assessment to determine that the benefits would outweigh such costs or, indeed, of the costs being incurred by DNOs, market participants and Ofgem itself in pursuit of this project to date.

- We also believe that Ofgem's proposals would have an adverse effect on competition in the supply and generation markets, by increasing uncertainty and the perception of regulatory risk.

- LRMC charging based on a forward-looking view of possible costs is, in our view, inherently unstable and extremely sensitive to input assumptions. This has been shown to be the case as the electricity transmission charging model has been developed. This concern would be even greater at distribution level with the smaller capacities and plant sizes and greater number of network "nodes".

As we have argued before, stability for customers should be a policy goal for regulation in this area, particularly since there can never be a definitively "right" approach to network charging. In addition, should locational transmission losses be introduced, we would expect Ofgem to "revisit the method of calculating TNUoS charges so that they [participants] are exposed to a consistent set of short and long-run signals and charges", as indicated in December 1999. This approach should ensure stable and consistent signals are provided through both locational TNUoS charging and losses.

<u>Competition in Connections</u>
Ofgem has recently proposed an extension of competitive arrangements for connection work. We have concerns with this and, in our response, advocated a review of the current arrangements and the benefits likely to be obtained if the current framework was extended. We therefore support Ofgem's plan to consult on the development of this area of competition. Any further initiatives by Ofgem in this area should be justified by rigorous impact assessment.

<u>Licensing of off-shore cables</u>
We welcome the proposal to extend the GB transmission arrangements and regulatory regime to offshore networks and look forward to working with Ofgem in this respect.

Security of Supply
We recognise that this theme has interactions with work in the other regulatory areas.

Wholesale Gas Markets

Our greatest concern in this area is the structure of the wholesale market for gas, with the knock-on effects on electricity generation. Gas prices continue to be high and volatile with concerns expressed about both the information that is available from UK offshore gas producers and arrangements in continental Europe. We support Ofgem's involvement with the European Commission on this issue and the continuing efforts to see greater publication of information on availability of supplies entering the British gas network. However, we would also urge Ofgem to undertake a formal review of the UK's offshore market to ensure that these arrangements are not acting against the interests of competition and UK consumers.

Wholesale Electricity Markets

We would most welcome continued stability in the cash-out arrangements in electricity. Changing to a more marginal cash-out regime is likely to reduce liquidity and deter new entry, as noted in the EU Commission's Energy Sector Inquiry findings. In addition, such marginal prices will feed into the forward markets increasing wholesale prices in the longer term. We do not believe that such a change will be a benefit to the market or customers.

Transmission Charging

We have also expressed concerns that the extreme pricing signals for the north of Scotland zone that emerge from the currently approved transmission use of system charging methodology might lead to the closure of otherwise efficient generating plant. As noted above, we continue to believe that the new transmission use of system charges that were introduced as part of BETTA result in a punitive locational signal that is not reflective of the underlying costs of the transmission system. We would therefore urge Ofgem to complete the promised review of transmission charges, which was a condition of approval of NGC's charging methodology.

On the other specific issues mentioned under this theme, we have the following comments.

Gas Quality

We recognise that this is an issue for security of supply going forward and are aware that the DTI is already consulting on the matter. We are concerned to ensure that any knock-on effect on the operating costs or asset lives associated with the gas distribution infrastructure is recognised in the gas distribution price control framework.

Demand Side and Fuel Switching

It is clear from this winter, that demand reduction and fuel switching can make a significant contribution to security of supply. It is important therefore that Ofgem facilitate customer and generator involvement. This is particularly important at times of system stress to guarantee supply in the interacting electricity and gas markets. Ofgem can assist in this process through the approval of changes that would put the maintenance of security of supply above participants commercial interest at times of system stress and by minimising the balancing risks inherent in fuel switching.

Generation Investment

We agree with Ofgem about the importance of new investment in the electricity generation sector. In our view, this is one of the biggest issues affecting the energy sector in the coming decade. We also agree with the comment that "investors will expect a stable political and regulatory environment before making investment in new capacity". This lines up with our theme on Ofgem making "stability" an explicit regulatory policy objective such that change is driven largely by industry. Our comments on the structure of network charges are also relevant here.

Europe

We recognise that this theme has interactions with work in other regulatory areas – in particular, the security of supply issues discussed above. We support Ofgem's proposed approach to encouraging the enforcement of existing obligations elsewhere in Europe. We also hope that Ofgem can protect the open, British markets from additional intrusive regulation targeted at less competitive European markets.

On the specific issues mentioned under this theme, we have the following comments:

- We welcome Ofgem's intention to keep industry aware of relevant European developments and provided with opportunity to engage in the debates;
- On gas storage, we believe that the level of regulation of this activity is about right in the UK, with the negotiated access arrangements that have been adopted. We would look to Ofgem to protect the UK from imposition of further regulatory burdens in this area rather than seeking to bring in additional regulatory oversight.

Environment

Whilst Ofgem's desire to use market orientated policy instruments has a place in meeting environmental targets, it has to be recognised that the industry is one of long lead times and requires stability for the necessary, substantial investments to be made. It is therefore also appropriate for changes imposed via regulation to take account of historic investments. An example of this is the allocation of allowances under the EU ETS. We believe that there is a continued need for phasing of the granting of allowances with auctions to manage those historic investments in order to prevent stranding of assets and premature closure of plant, which would bring increased risks to security of supply.

Ofgem are central to the change processes under the Codes that govern the industry. We would expect to see a robust Ofgem analysis and impact assessment of every proposal for change that could impact on the current environmental situation. This is particularly important where changes will alter the running patterns of low carbon generation through different locational signals or market pricing arrangements.

As noted above in our comments on the security of supply theme, we believe Ofgem have an important role to play in ensuring the market arrangements facilitate the use of demand side measures and fuel switching at times of system stress. There may at times be a need to balance environmental objectives against those of security of supply. However, Ofgem's primary role at these times should be to ensure continued supply to customers as a priority over their environmental obligations. The environmental requirements at times of system stress will be managed by the other Government bodies such as Defra, the Environment Agency and SEPA.

In relation to the administration of Government schemes such as the RO and EEC, we would expect Ofgem to be flexible in their approach to the acceptance of submissions for compliance under the schemes. A proportionate response is required, such that participants should not be deemed in breach of their obligations through a simple administrative oversight. We would also like to see increased transparency of Ofgem's costs in administering the schemes.

Fuel Poverty

We agree that this is an issue that needs to be considered holistically. We recognise that the energy industry has a role to play but, in our view, coordinated action by government is also required, for example in the interaction between energy billing and benefit schemes.

In considering Ofgem's list of initiatives under this theme, we are unclear whether some of the detailed monitoring proposed is actually part of Ofgem's role. For example, "mystery shopping exercises and benchmarking surveys to track performance and help identify best practice … in relation to debt and disconnection and provision of frontline advice to vulnerable customers." We are not clear what value such regulatory initiatives will deliver for customers.

Better Regulation

We note the change in name of this theme from previous years ("improving Ofgem's efficiency and effectiveness") to the more broadly-based better regulation agenda. We certainly welcome Ofgem developing a de-regulatory approach and are of the view that there could be even greater emphasis by Ofgem on the "good regulation" principles of proportionality and targeting. In essence, we believe that Ofgem should leave market participants to drive change in competitive markets and not contribute itself unnecessarily to the pace of regulatory change. If this approach was taken, we believe Ofgem could thereby reduce its staffing requirements and therefore the direct and indirect costs it imposes on the industry through licence fees and policy initiatives respectively. Therefore, while we welcome Ofgem setting up a unit for better regulation, our expectation is that this unit will lead to a reduction in regulation and therefore also in the costs of regulation, by a significant margin, over the period of the corporate plan.

<u>Ofgem's Budget</u>

We welcome Ofgem's setting out the outline budgets for the period of the 5 year plan and hope that a stable set of cost headings will be maintained over this period so that stakeholders can review changes from year to year. For 2005/06, it is difficult to directly compare the detail of Ofgem's budget and actual expenditure. Presentation of costs in Ofgem's final strategy document for 2005-10 showed the 2005/06 budget with overheads allocated to the different themes on a gross basis. The current document shows costs by theme on a net basis, with central and overhead costs shown separately. However, an overview comparison reveals a discrepancy: £2.0m was allowed for contingency in the 2005/06 budget in the final 2005/10 corporate strategy document whereas that figure in the current document stands at £2.5m and is set to grow over the period of the 5 year plan. Rather than awarding itself increasing budgets for contingency (which are disallowed in network company price controls), we suggest that Ofgem develops the discipline of re-prioritising work when unforeseen demands are placed on the organisation.

Reviewing the expected change in total costs from 2005/06 to 2006/07, we are disappointed to see that Ofgem's total costs are planned to increase by £1m, although we note that the document also comments that additional savings over 2005/06 budget might yet offset this headline increase. The document explains that the headline increase is largely due to the increased costs of managing the environmental programmes which are outside the RPI-3 cost control regime. It is a little difficult to follow what is happening to the total and net costs of administering environmental programmes and we suggest that this item of reconciliation be further explained in the commentary in future years.

Project Paperless

Having participated in discussions with Ofgem's consultants as part of Project Paperless, we are somewhat disappointed with the outcome of this project to date. The tangible results appear limited to a redesign of documents and an intention to redesign the Ofgem website and introduce electronic records management. Our discussions with the consultants were more wide-ranging than this, including for example the key areas of overall quantity of consultation documents and development of regulatory impact assessments.

On the positive side, we do acknowledge that this particular consultation document, as an example of the new document format, feels more concise and readable than earlier consultations on similar subjects. We are interested to note the planned review of the website and hope that this will make it easier to "see at a glance" the range of issues on which Ofgem is seeking views at any one time. On this theme, we believe that all "open letters" and similar communications should be numbered and notified on the website. We are aware of several areas where documents are put on the website in one of the (>100) "areas of work" but not flagged up in the general list of publications. Linked to this, it would be helpful for every document that is added to the website to be flagged in the website notification service. Even if it was felt advisable to have more than one notification service to cover different areas of stakeholder interest, it should be possible, in our view, for stakeholders to be advised electronically of the publication of every document that Ofgem puts onto its website, if they wish.

We also note Ofgem's intention to review its approach to impact assessments (IAs), although we do not see any specific deliverable proposed for this. As noted above, we have made a number of suggestions to the Project Paperless consultants on this theme, including:

- Solid and quantitative analysis should be undertaken by Ofgem before policy proposals are put forward for consultation, thereby beginning the process of assembling the IA;
- IAs should be carried out for current initiatives that have never been subject to an IA;
- The "do nothing" option should always be assessed; and
- The final IA should include a plan for how the chosen policy is to be assessed for success after implementation.

Finally, Project Paperless has as a declared theme the "quantity" of consultation documents. We very much support Ofgem's intention to reduce the number of documents produced in 2005/06 by 20% compared to 2004/05. As discussed above, the count of documents should include all documents placed on the website. We firmly believe, in particular, that Ofgem should monitor and control the burden of consultation that it places on industry and seek to minimise the number that are open at any one time. While proper consultation is an indispensable part of good regulatory process, the consultations issued do represent direct as well as indirect costs for industry since the staff time required to produce and process consultations adds to the direct resources Ofgem needs. We recognise that an absolute limit on such consultation would never be practicable given Ofgem's statutory duties but, in our view, there is no reason why Ofgem could not set and monitor internal targets for "business as usual" activity. As in the business sector, consideration should be given to deferring some areas of work where there is danger of too much being undertaken at once.

Performance Indicators

There is no indication of the timeframe for any of the activities under wholesale markets or enforcement.

Views on unnecessary administrative burdens

We welcome Ofgem's engagement with the concept of reductions in regulation, as articulated by the proponents of the better regulation agenda. We certainly believe that there are a number of areas where the burden of regulation could be reduced and we set these out below.

- General. As discussed in our covering letter, we believe that Ofgem has an important duty to minimise the burden of change initiatives and consultation that it imposes on the industry at any one time. In this regard, we welcome the commitment under project paperless to reduce the number of consultations by 20% in the current year compared to last year.

- Supply. We are participating in the review of the supply licences and hope to see a substantial reduction in the scale and scope of these licences as a result. Some specific items from the supply licence that we would suggest as being candidates for removal are as follows:

  * SLC 44 - notification of terms, paragraphs 6 & 7
  The requirement that applies where a supplier unilaterally varies any term of a domestic supply contract to a customer's significant disadvantage (includes increasing the price), the supplier must within 10 days of the variation give to the customer written notice of the variation, of the customer's right to terminate the contract, and where they do so within the following 14 days the supplier cannot enforce the variation.

  * SLC 17 - reading and inspection of meters
  Obligation to use all reasonable endeavours to inspect any (gas) meter once every two years.

  * SLC 48 - marketing condition
  This condition should be removed in its entirety from March 2007, subject to the level of complaints staying at a consistent level.

  * All metering licence conditions
  These should all be removed from the supply licence and consideration given to where the obligations should sit.

  * Code of practice/reporting/vulnerable customer obligations
  The majority of these obligations should be removed from the licence, with a bare minimum of obligations retained in the licence and suppliers left to offer additional measures on a voluntary basis.

  * Section D, containing ex-PES or Centrica only conditions
  All of section D should be deleted from the licence as there is no longer a case for retaining specific obligations on the ex-PESs, in particular in the case of electricity.

- Electricity Distribution. There are two main areas to comment on: firstly, the burden of charge structure development and secondly, introduction of the distribution connection and use of system code (DCUSC).

  The continual Ofgem-driven review and development of network charging policies is one of our major concerns and we have discussed this under the networks regulatory theme above. The current project on electricity distribution charging, which has been underway since the year 2000, imposes non-optional costs on the DNOs in attending meetings, responding to consultation papers and generally providing input to the development of regulatory policy. We are strongly of the view that Ofgem should allow DNOs, as envisaged by the licence conditions on charging methodology, to control the process of developing charge structure methodologies without involving themselves in the detailed direction of this project.

In respect of the DCUSC, we have consistently argued against Ofgem's proposals to replace existing arrangements for connection and use of system contracts. In our view, the DCUSC will be overly bureaucratic and will introduce an additional administrative burden for DNOs, for no benefit to customers. We recommend that Ofgem keeps this initiative under review and conducts retrospective assessment of the costs and benefits of initiating this new governance regime.

- <u>Gas networks</u>. We believe there is a need to rationalise the Overall, Guaranteed and Connections Standards, to make them more focused and less confusing to customers. For example, the Overall Standards could be removed or brought into the quality of supply reporting framework, as in electricity arrangements. There are also too many Connections Standards, which are confusing and could be rationalised with a much clearer focus. In our view, the Guaranteed Standards should also be reviewed to consider whether they are meaningful and measurable.

  In another area, we consider that the metering obligation of last resort is an unnecessary burden for gas DNs. The DNs do not own meters: for example, the independent DNs did not acquire meters as part of the DN sales process, as these were retained by National Grid Metering (NGM). Our DN businesses are not meter operators and fulfil the last resort obligation by sub-contracting. To become a meter operator involves significant costs in establishing the required systems and still imposes a burden when sub-contracting is used. In our view, the obligation to provide metering services clearly lies with NGM.

- <u>Transmission</u>. In transmission, there is an inconsistency in the timing of regulatory submissions compared to distribution. In the past few years we have sought a dispensation to align the submission timetable so that the audited returns for the transmission and distribution businesses can be carried out simultaneously, which we believe is more efficient. We firmly believe that the special condition L in our transmission licence should be amended to formalise this arrangement.

- <u>Generation Wholesale</u>. The NETA market has been in place since 2001, and a relatively efficient expansion to cover GB took place in 2005. Any potential issues with the operation of the GB market were highlighted in the consultation process that preceded BETTA. In particular, network constraints were clearly identified as an issue for TOs to manage in consultation with the SO, rather than an area for market development. These are the same as have occurred in the past in E&W and were resolved there through contractual negotiation and/or reinforcement of the network. Now that a GB market has been established we would not expect Ofgem to be involved in the operation of the Scottish "zone" and would find it unacceptable for generators in Scotland to be treated differently to their counterparts in England and Wales with respect to constraints.

As discussed earlier, we believe that Ofgem should set up a project to assess whether scope exists to reduce Ofgem's involvement in the operation of the wholesale energy markets, particularly electricity. For example, now that NETA and BETTA have been successfully implemented, we would question whether it is necessary for Ofgem to continue to approve or reject all changes to the industry codes.