



taking care of the essentials

Ofgem's Five Year Strategy 2007 - 2012

A Centrica response

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1 INTRODUCTION

We welcome the opportunity to contribute to the development of Ofgem's five year strategy. In response to Ofgem's open letter of 1 August this response outlines the areas which we believe should be reflected within that strategy.

In our view the key challenges facing Ofgem are as follows:

1. energy liberalisation in other European markets;
2. the continuing reduction in the burden of regulation and governance;
3. the reform of gas settlement arrangements;
4. ensuring that networks are regulated effectively;
5. removing barriers to innovation regarding metering; and
6. environmental policy developments following the Energy Review.

2 EUROPEAN LIBERALISATION AND THE MARKET IN GREAT BRITAIN

2.1 THE CHALLENGE

In July 2007, energy markets across Europe will be fully liberalised. At the same time, European countries are becoming more import dependent for their gas supplies. Great Britain is in turn also increasingly dependent on access to transportation infrastructure in other countries in order to receive these imports and help ensure security of supply. The success of liberalisation on the Continent will thus have a direct impact on energy consumers in Great Britain.

2.2 WHAT WE WOULD LIKE OFGEM TO DO

Ofgem's experience and expertise in the shaping of competitive markets is widely respected and we have welcomed Ofgem's engagement with other national regulators, the European Commission, CEER and ERGEG in particular. The recently launched regional market initiatives are an important tool in the Northern/North-Western region which is of particular significance for British interests. We fully support and welcome Ofgem's involvement with a view to facilitating the development of liberalised markets and pipeline access throughout European energy markets. It will be important for the success of such initiatives that all stakeholders are fully involved; we would therefore encourage Ofgem to ensure there is an effective dialogue with all market participants.

From experience last winter, an important area for engagement is the monitoring of security of supply arrangements on a pan-European level. In the interest of information transparency the results of such a monitoring exercise should be shared on a timely basis with the wider market.

Ofgem's involvement at the European level is equally important to ensure that any legislative or regulatory proposals at this supranational level address the deficiencies of the current directives and regulations in bringing about an effective internal market. Any such developments should not lead to additional costs to customers through the introduction of unnecessary or complex requirements on market participants.

2.3 THE PRIORITY

The liberalisation of European energy markets and the creation of well functioning internal markets in electricity and gas is the biggest challenge facing the industry today. The British Isles' position on the periphery of the European Continent could mean that consumers here may suffer disproportionately compared to those in other countries. Ofgem, along with its fellow regulators in Northern Ireland and Eire have a crucial role in ensuring efficiently working European markets, which are essential to the well being of UK consumers.

3 THE NEED TO REDUCE THE BURDEN OF REGULATION AND GOVERNANCE

3.1 THE CHALLENGE

We have been encouraged by the Supply Licence Review, but believe that much more should be done to reduce the burden of regulation upon suppliers.

Ofgem should not hesitate to push the boundaries on unwarranted regulation even further. The energy supply market is both mature and competitive, and accordingly energy suppliers should be afforded more freedom to self regulate, for example through voluntary codes of conduct. Furthermore many of the areas awarded protection by the licences are suitably covered by general consumer protection legislation. Reducing the burden of sector specific regulation could in turn lead to greater innovation in the market.

3.2 WHAT WE WOULD LIKE OFGEM TO DO

Together with industry, Ofgem needs to consider the governance arrangements in their entirety, not simply from a compliance perspective, but from a structural and strategic viewpoint.

Ofgem's enforcement activities should be focused on regulated network operators, with its role in supply competition limited to market monitoring, responding to market failures and licence breaches where necessary. To further this point we consider it timely for Ofgem to deliver on its long standing commitment to review metering standards of performance, in particular to challenge their continuing relevance in a competitive market.

3.3 PRIORITY

The priority given here to the reduction in the burden of regulation and governance is not only due to the direct costs of compliance but also due to the indirect costs placed on business through the need to build and maintain unnecessarily complex and costly internal processes.

4 ENSURING EQUITABLE AND ACCURATE GAS SETTLEMENT ARRANGEMENTS

4.1 THE CHALLENGE

The arrangements concerning gas settlement are no longer fit for purpose. The measurement mechanisms from beach to meter are primitive, and the arrangements for balancing and reconciling energy and resultant application of the reconciliation by difference process across the small supply point market are inequitable and antiquated.

The key challenge is to ensure that all gas settlement arrangements are fair, accurate and fit for purpose, and that these arrangements do not unfairly disadvantage individual market sectors or participants. In doing this we must make sure that the arrangements themselves are efficient and not overly burdensome.

4.2 WHAT WE WOULD LIKE OFGEM TO DO

Whilst industry code mechanisms will allow some tactical improvements to present day arrangements, we believe Ofgem should undertake a full feasibility study with regard to introducing meter point reconciliation in to the gas balancing regime and to sharpening the incentives on distribution networks relating to theft and losses.

4.3 PRIORITY

It is essential for Ofgem to ensure that gas settlement arrangements are fair and not biased against certain market sectors, market participants and customers.

These settlement arrangements are not unimportant and are responsible for the allocation of billions of pounds in cost.

5 NETWORK REGULATION FRAMEWORK

5.1 THE CHALLENGE

Recent changes to the sources of gas and the types and locations of power production in Great Britain are slowly having an effect on network planning. The greater role for distributed generation highlighted in the Energy Review will require investment by electricity distribution network operators over the coming years. Similarly the new landing points for gas imports, whether by pipeline or LNG, are already subject to network investment by National Grid. At a period when suppliers are under pressure to contain price increases in light of high wholesale costs, network tariffs and the composition of price control reviews will be subject to additional scrutiny by suppliers.

Ofgem must be more challenging of the current industry structures, in terms of their fitness for purpose, the direct costs associated with them and the burden they can place on suppliers. There is strong potential for the replacement of core gas and electricity systems during the timeframe of this Ofgem strategy, e.g. according to the gas distribution price control review, the UK Link will be replaced within the next price control period.

5.2 WHAT WE WOULD LIKE OFGEM TO DO

It is important that Ofgem monitors network access tariffs to ensure that no unwarranted increases are made that ultimately lead to upward pressure on end-user prices.

Linked to this is a request that Ofgem publish details of key network price control elements at an earlier date than has previously happened, to allow suppliers sufficient time to review their own charges to customers. We understand that for the next two gas distribution price controls (covering the period from April 2007 to March 2013) details of cost of capital, planned allowed revenues etc. will not be available until three months before they come into effect. This is not practical from a supplier perspective and the proposed three month lead time should be extended to at least 12 months. Whilst some fine tuning is to be expected nearer the time, we see no reason why robust estimates cannot be provided. This extension to the lead time would enable a smoother path for end customer prices.

We welcome the consultative approach taken by Ofgem for industry dialogue on the proposed xoserve service and future UK-Link plans.

We acknowledge the success of the new Distribution Connection Use of System Code and would encourage Ofgem to work with the industry to bring as much transparency as possible to this element of the market as we move from development into implementation phase.

In their interaction with transporters, we would now expect Ofgem to demand to see evidence of the benefits of the distribution network sales starting to be passed on to customers. As yet there has been little innovative thinking around possibilities of realising the benefits that were claimed would arise from the transaction.

5.3 THE PRIORITY

The level of investment in gas and electricity networks is not insignificant. Ofgem must ensure that the effect on costs is justified and efficiently allocated through future network tariffs.

6 INNOVATIVE METERING

6.1 THE CHALLENGE

We welcomed Ofgem's strong statement in support of metering competition earlier this year, and appreciate Ofgem's work to address some of the prevailing barriers to metering competition.

Innovative metering is at present a high profile issue. It is important that developments in this area are market led and that suppliers have freedom to innovate and deploy smart metering in a way which is best for them and their customers.

We see the challenge for Ofgem as one of facilitating and supporting the market, and ensuring that political pressures do not result in unjustified or inefficient policies with regard to innovative metering.

6.2 WHAT WE WOULD LIKE OFGEM TO DO

While Ofgem must continue to review and remove the remaining barriers to metering competition, a key priority for the immediate future is for Ofgem to oversee and coordinate industry work which will facilitate the introduction of meters with enhanced functionality.

In addition we believe there is a key role for Ofgem in ensuring that the different areas of Government understand the facts with regard to innovative metering and have accurate information with regards to cost, benefits, issues and risks.

6.3 PRIORITY

Whilst the potential environmental benefits of smart metering are far from clear at present, there are commercial attractions for installing innovative meters in particular circumstances and market segments. The priority for Ofgem should be to facilitate industry work on the necessary framework which will support the introduction of innovative meters within a competitive metering market and to remove regulatory obstacles to their deployment.

7 ENVIRONMENTAL POLICY DEVELOPMENTS

7.1 THE CHALLENGE

A key element in the Energy Review was the increased importance given to energy saving. The policies recommended in the Review could bring about a change in the interaction between energy supplier and customer, with a greater emphasis on energy efficiency. This and other policy developments put forward in the Energy Review – decentralised generation, renewables, microgeneration, etc. – signal a potential change in direction for energy market participants in the years ahead.

7.2 WHAT WE WOULD LIKE OFGEM TO DO

The environmental policy developments suggested in the Energy Review could mean Ofgem having to facilitate numerous changes in the energy industry. Whatever the outcome of forthcoming consultations resulting from the Review, it is crucial that Ofgem gives a clear direction and leadership for market developments. This is not limited to areas that are directly linked with environmental policy such as the forthcoming EEC3 but also areas where the impact will be indirect, e.g. distributed generation and network price controls. Consultations must be carried out with market participants in a timely fashion and robust cost benefit analyses will be crucial to ensure eventual success.

7.3 PRIORITY

Environmental policy has long been a feature of activities in the energy market. Nonetheless the Energy Review indicated a step change in the level of involvement expected by Government. If market participants are to be encouraged and enabled to deliver, Ofgem must work with Government and industry to facilitate this. Timely and clear signals will be crucial if investments are to occur that ultimately deliver the Government's energy and environmental policy objectives.

8 CONCLUSIONS

In summary, we need continuing focus from Ofgem on those markets which are not working, such as Continental Europe; involvement in those areas where suppliers need protection from monopolies and where Ofgem can provide leadership and direction, e.g. metering; and more radical approaches to reducing the burden not only of regulation, but of governance generally in the market in Great Britain.

We would welcome the opportunity to discuss the issues addressed in this response in more detail and look forward to continue working with Ofgem in the development of its future strategy.