



**Legal, Regulation and
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[By E-mail: Andrew.mcfaul@ofgem.gov.uk](mailto:Andrew.mcfaul@ofgem.gov.uk)

Dear Andy,

Re: Proposed revised guidance on impact assessments

Thank you for the opportunity to comment on the above document, this non confidential response is on behalf of Centrica plc excluding Centrica Storage Ltd. We are happy that Ofgem place this response on their website and in the Ofgem library.

In general terms, we support many aspects of the proposed revised guidance. We are in favour of Ofgem conducting rigorous impact assessments (IAs) on important policy changes as well as code and charging methodology modifications. We support the approach of conducting IAs only for important issues; we would not wish to see industry processes delayed by unnecessary IAs. Equally, we do not believe it is appropriate for the fact that an Ofgem IA is to be conducted to be used as the basis for alterations to normal industry processes. For example, in respect of the Electricity Distribution Charging Methodology proposals, the G3 group indicated at the DCMF that they did not plan an additional consultation on the basis that Ofgem had indicated they would be consulting (via an IA). In our view this is inappropriate, as a properly conducted consultation by G3 (including, as previously requested by suppliers, clear impacts on customer groups) could only improve the quality of any subsequent IA.

At a high level, we believe Ofgem produces IAs of reasonable quality, however we do have some significant concerns concerning how IAs have been produced in practice. In addition, we consider that the guidance requires strengthening mainly in the area of cost benefit assessment, as it does not address some current weaknesses.

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At a high level, Centrica disagrees with the Ofgem position stated in paragraph 2.4¹. Ofgem's statutory duties require decisions to be taken on an economic and efficient basis, in our view this cannot be properly achieved without paying due regard to rigorous cost benefit analysis (CBA). We believe that where available, decisions must be based on properly quantified data and for Ofgem to disregard this as "inappropriate emphasis" is very worrying. The clear conclusion of the text is that Ofgem would take decisions leading to net costs to customers.

We have frequently raised concerns in respect of specific IAs that they have been conducted with insufficient rigour. Ofgem has disregarded clear quantitative evidence in favour of inadequately specified qualitative evidence. We have also highlighted that where qualitative evidence is used, for example, 1, 2 or 3 ticks or crosses, it is essential to provide some understandable, objective definition of what one "unit" equates to. Unfortunately, in such circumstances, such definitions are not provided, leading to the conclusion that the categorisation is purely subjective. Examples of this are contained in the IA on Exit reform and several of the IAs associated with DN Sales.

We are sympathetic to the difficulties experienced by Ofgem in quantifying costs and benefits, but believe that these difficulties justify the effort involved, especially for major IAs. If the CBA is so difficult, it argues that the decision is very finely balanced and hence extra care should be taken to ensure it is the right one. In the proposed drafting, in chapter 5, Ofgem states that where a CBA suggests a clear cut decision, greater weight will be attached. Where there are wide ranges of uncertainty associated with the CBA, then they would attach less weight. Centrica believes that this is incorrect. Where a decision is finely balanced, the correct course must be to improve the quality of the analysis, not to revert to unquantified, subjective assessments.

A further area of concern is the introduction of new evidence at a late stage in the process. Clearly, additional work and evidence gathering on finely balanced decisions is to be welcomed, especially where this adds materially to the debate. However, we believe that it is inappropriate to introduce new evidence as part of the final IA. Where new evidence is material, it should be drawn to the attention of the industry by the appropriate route, for example, via the relevant modification panel on Code related IAs, and directly by Ofgem on policy decisions. If the evidence is sufficiently material to influence the Ofgem decision, then it is essential that key stakeholders have the opportunity to review and comment on the evidence before it is used in decision making. It may be that this may lead to a short delay in the process, but we believe that this is a more appropriate outcome.

In terms of the basis for assessment, we note and agree with Ofgem's view that the base case will often be the "no change" option. However, this is not always the case. Centrica has previously raised significant concerns in this area, both during Exit reform and DN Sales. Where the base case is not the "no change" option, usually because this is not viable, it is absolutely essential that the costs of getting to the base case are included in the IA and taken into overall consideration. Failure to acknowledge these costs leads to a flawed conclusion for the IA. For example, in the IA on Modification 116, transporter costs in the region of £20m were discounted as they had previously been allowed for in DN Sales. Clearly, the cost should not be paid twice, but it must be incorporated as a cost of the change. On this basis, we believe that where the base case is not the "no change" option, Ofgem's IAs may be seriously flawed.

¹ "We do not propose to use the BRE's template summary sheet on analysis and evidence. We consider that it places too much emphasis on quantified costs and benefits and overplays the likely role of CBA in Ofgem decisions given our statutory duties. The emphasis on quantified data is inappropriate for an economic regulator such as Ofgem as we have to take decisions based on our statutory duties and not solely and strictly on a 'net benefit' test."

We acknowledge that Ofgem has, in some cases, to rely on industry participants or other third parties to provide information, which Ofgem acknowledges. In addition, in paragraph A5.12, Ofgem asserts that parties may exaggerate costs or downplay benefits (or vice versa) according to their view of the policy under discussion. Given licence obligations, we believe that regulated parties will do their best to provide good quality data and their genuine view of the proposals. With this in mind, we have previously been concerned by Ofgem's actions in discounting data they assess as "outliers". It is not unreasonable that different organisations will have different costs. This would be expected in a competitive market, and disregarding such variation at best reduces rigour, and at worst may lead to flawed decisions.

The final part of the IA is the post implementation review (PIR). Centrica has been very disappointed with the lack of PIRs carried out after IAs. In our view, if a change is sufficiently important to merit an IA being conducted, then there should be no doubt that a prompt and detailed PIR will be carried out. The only questions should be over the timing of the PIR and whether PIRs should be carried out at intervals – for example, after 1, 3 and 5 years for really major change. We would also stress that where decisions have been made based on qualitative data (however well explained), the PIR is even more important and must be brought forward to the earliest opportunity to ensure Ofgem is held fully accountable.

To illustrate our concern, DN Sales clearly carries the risk of costs to customers, for extremely limited benefits spread out over 18 years. The IAs and consultations carried out failed to adequately address how delivery of benefits would be tracked and, more importantly, accurately attributed to particular changes to avoid the risk of double counting. Overall, we believe this whole area requires more rigorous treatment.

A final point for consideration in respect of the PIR is to ensure that it covers not just the policy decision, but how accurate and hence successful the IA was. This is necessary both to quantify the actual cost to customers of [poor] decisions and to support continuous improvement.

Reflecting on non Section 5A IAs, we are not averse to these being carried out, at a greater or lesser level of detail, providing that the early IA is not seen as a substitute for a proper IA being conducted later. In addition, where qualitative justification has been used, this should be updated to quantitative analysis as soon as is practicable.

We trust these comments have been helpful, and if you would like to discuss any of the points raised above in more detail, I should be happy to help.

Yours sincerely,

By e-mail

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