



Legal, Regulation and Compliance

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Andy McFaul
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By E-mail: Andrew.macfaul@ofgem.gov.uk

Dear Andy,

Re: Ofgem Corporate Strategy 2008-2013

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.

We have addressed the questions under the same chapter headings as those used in the document.

Chapter 1: Creating and sustaining competition

Question 1: Does this theme remain valid?
Centrica agrees that the theme itself remains valid.

Question 2: Have we identified all the relevant issues within the theme?
Centrica believes that there are four additional issues which should be taken into account when addressing this theme:

1. The impact of the complexity and interaction of key downstream aspects of industry arrangements on the effective functioning of competitive markets, for example, the supplier hub and the current metering model. In the case of the latter, Smart metering would add additional complexity that the present industry design is unable to support. We believe that strategically, radical reform to downstream industry arrangements is required to enable service providers such as xoserve and Elexon to respond adequately to the challenges and opportunities ahead. Ofgem should have regard to the recent withdrawal of services by Meter Services Limited which reinforces our view that the metering market is uncompetitive.

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2. The removal of inappropriate allocations of industry charges to suppliers such that undue cross subsidies which exist between supplier, market sectors and consumers are removed, for example, the allocation of all gas industry imbalance costs (RbD) to domestic customers only
3. Ensuring that appropriate levels of separation from the monopoly network businesses are maintained such that the competitive market is not distorted. We would welcome greater visibility of the market assurance activity that Ofgem undertakes in this area.
4. A new National Consumer Council will be established in 2008 and it is critical that there is a smooth transition of responsibility from energywatch. We look to Ofgem to take a proactive lead in ensuring that this transition is timely and effective.

Question 3: Is Ofgem's approach to the challenges ahead the right one?

Ofgem's involvement must be both timely and appropriate. We believe Ofgem should act principally in response to calls from the market and consumers for intervention save where (after due process of consultation) it considers that broader industry reform is called for, in order to properly deliver on its statutory duties. The trigger points and mechanisms for such intervention are unclear and lack transparency, constraining the ability of trading parties to seek increased Ofgem involvement where this is deemed necessary. We would welcome greater Ofgem involvement within the development stages of industry change. Without fettering the discretion of the regulator to decide on proposals with independence, it would be beneficial to development were there to be greater understanding of the regulatory concerns in respect of proposals under discussion.

Ofgem references the industry-wide group set up to agree minimum standards for smart meters. We do not believe that this group has been proactive enough to date, it has not delivered standards nor has it proposed changes to allow for the wider use of technology. Instead numerous other fora continue to consider these requirements. We believe a co-ordinated approach would be preferable. In addition, the output from the Smart metering trial should be published, even if caveats are required.

In respect of Green Supply Guidelines (1.18), whilst fully supportive and committed to the underlying principles of reducing customer confusion in relation to green supply offerings, we do not believe that the proposals are appropriate. We will continue to work in collaboration with ERA members and other suppliers in the development of a suitable model, based on the following principles:

1. Additional Green Benefits – demonstrably arising from sale of a green product; and
2. Customer Education – for example, a ratings scheme which educates customers on the comparative environmental benefits of competing green products.

Chapter 2: Regulating networks effectively

Question 1: Does this theme remain valid?

Yes, in our view, the effective regulation of monopoly networks is one of Ofgem's most important duties, since it also involves the protection of consumers and promotion of competition.

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

There is a need for greater information transparency and a reduction in the information asymmetry between network companies and suppliers/other stakeholders, for example, during price control reviews. It would be beneficial to explore further alternative methods to support the consultation process, such as requiring DNOs to share and consult on their business plans. Greater transparency of the configuration and operation of networks would give users more understanding and confidence that this is optimal. This is of particular importance where the operation of the network is so closely related to the effective operation of the market, as is the case for National Transmission Systems.

This relationship between the market and the network is a key feature in the regulation of the networks. Good examples of this are the current issues around (gas) Entry and Exit capacity. Whilst we recognise that the efficient provision and operation of the network is a central objective, this should be tempered with the consequences of such efficiency on operation of the market overall. Modest efficiencies in capacity provision have been seen to lead to distortions of a liquid market and inflated commodity prices. This cannot be in the best interests of consumers.

At a more detailed level, Suppliers and generators require the ability to propose changes to the charging methodologies. It is unacceptable that there is no mechanism at present for suppliers to initiate improvements or to formally dispute, vary or appeal changes proposed by the networks. Charging methodologies must be cost reflective and transparent, hence when developing charging methodologies the impact upon charges of each individual element of a proposal must be clearly and simply set out by the network.

Electricity charging methodologies are of particular concern with multiple charging methodologies being developed over different timescales with varying levels of transparency. We believe that this whole area needs better co-ordination, with a primary focus on developing common, predictable and understandable charging methodologies.

Independent Gas Transporters (IGTs) should be identified as a specific work area. The IGT Uniform Network Code has provided a foundation for improvement, but progress has been slow especially in the area of customer transfer arrangements, where different data standards, service levels and performance persist. In addition IGT charges for a number of services such as provision of estimated readings appear excessive.

Question 3: Is Ofgem's approach to the challenges ahead the right one?

Ofgem can secure a better deal for customers in the next electricity distribution price control by engaging stakeholders more fully and maximising the transparency of the process. Suppliers need timely access to greater levels of information than has been the case. In addition, stakeholders, such as customers and suppliers, should have a greater degree of influence over the services provided and funded. Centrica is keen to take an active role in the forthcoming electricity DPCR and engage fully with Ofgem and the DNOs.

Centrica has provided detailed input over the last two years to the gas DPCR and we welcome the specific comments in the document on returning to the issue of triggers during the electricity DPCR. In terms of performance, we believe that participants are well placed to support Ofgem in the validation of Network Owner performance and incentive data, utilising feedback from customers and internal business metrics. Increased visibility of the performance of network owners and distributors, against incentive schemes, performance standards and obligations generally is needed.

Chapter 3: Helping to protect the security of Britain's energy supplies

Question 1: Does this theme remain valid?

A combination of competitive markets and effective regulation of monopoly networks is essential in maintaining security of supply. The price of carbon will have an increasing impact on future investment plans, feeding through energy prices; we agree with Ofgem that greater certainty is required with respect to future phases of the EU ETS.

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

The major issues have been identified, but in some cases insufficient emphasis is given. For example, Ofgem notes that National Grid will be encouraged to develop blending services enabling continental gas imports; however, we continue to have serious concerns that Ofgem's approach may not deliver the most beneficial outcome for consumers as a whole.

Question 3: Is Ofgem's approach to the challenges ahead the right one?

Ofgem should continue its efforts in Europe to ensure full and effective competition is in place across member states. The operation of the UK market is healthy and in our view requires limited regulation, reducing demands on Ofgem resources. We welcome Ofgem's assurance of light touch regulation for new infrastructure providers, and believe that this positive approach should be more widely applied.

Chapter 4: A leading voice in Europe

Question 1: Does this theme remain valid?

Ofgem correctly assesses the importance of this theme, which should continue to be a key focus of Ofgem's work in the coming period. With Britain and Europe's growing import dependency, the lack of effective competition across many European energy markets will have an increasingly significant impact on British energy markets and the interests of energy consumers in this country.

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

Among the issues identified by Ofgem, we would highlight the third legislative package and the development of regional markets in gas and electricity.

Central to the design and successful implementation of the third package is effective unbundling. We welcome Ofgem's support for full unbundling, which will assist the provision of transit and transportation across Europe and so enhance security of supply for Britain's consumers.

A major element of the third package for regulators is the growing need to develop an appropriate form of regulation to oversee increasingly integrated/interdependent energy markets. Whilst Ofgem and other regulators through CEER continue to make a major contribution, a co-ordinated European framework combined with enhanced powers for national regulators will be needed to ensure there is effective and consistent implementation of the package and that the proposed Agency is successfully introduced. We believe that greater co-operation and co-ordination between regulators will help facilitate the integrated market across the community. In the area of interconnection between the UK and mainland European networks, Ofgem has a specific involvement in ensuring that effective regulation supports the operation of the market.

Within the period of this plan, we strongly support Ofgem's engagement in ERGEG and CEER work on policy development and guidelines, which is essential to maintain the momentum of present initiatives. Through ERGEG, and, in due course, the Agency, Ofgem is well placed to address the risk of developments in continental Europe or at Brussels level which could undermine at least some of the benefits of liberalisation in Great Britain.

Finally in view of the growing extent to which environmental initiatives are undertaken within a European context, we welcome the combination within Ofgem of work on European and environmental issues, in view of the growing extent to which environmental initiatives are undertaken within a European context.

Question 3: Is Ofgem's approach to the challenges ahead the right one?

As noted above, we fully support Ofgem's general approach and constructive engagement with European issues. Ofgem's experience and insights are acknowledged and widely respected, and it must remain a key driver in the development of more competitive energy markets in Europe.

The challenges of creating regional markets are considerable, not least in the need to develop industry rules/codes. As is often the case, the devil will be in the detail, and an appropriate level of resources and expertise will need to be given to this area.

Chapter 5: Helping to achieve sustainable development

Question 1: Is this theme valid?

We agree Ofgem should have due regard to objectives related to sustainable development, and that this forms an important part of their work, hence the theme remains valid. However, it is important that an appropriate balance is achieved between work in this area and Ofgem's primary objectives.

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

Overall, the key points have been identified, though emphasis is lacking on some major issues, see below.

Question 3: Is Ofgem's approach to the challenges ahead the right one?

We broadly support Ofgem's sustainable development agenda. However, Ofgem should play a more proactive role in achieving consistency of policy across Government departments and providing clear leadership for industry.

On microgeneration, Centrica believes that Ofgem has underestimated some important issues in relation to the need for technological support; and reform of industry systems such that export can be properly credited to the supplier.

Moving to the Renewables Obligation, Centrica remains opposed to the idea of replacing the RO with a moving renewable premium that changes with the power price. We believe that that RO banding is the appropriate way forward, it also has the additional advantage that it manages not to disrupt investor confidence, as the Ofgem proposal would.

We believe that a cost-reflective and equitable cashout regime must be applied fairly to all parties, with no special provision for different types of generation. Costs incurred in balancing the system should be targeted on those parties causing them, even if that is by virtue of intermittency by design. It is also clear to us that any new solution should be an enduring one, and that any uncertainty can be avoided by addressing the suite of cashout modifications simultaneously when all are complete. Care is required in considering the way forward on locational transmission losses charging, as this could unfairly penalise generators in northern Scotland, where siting decisions are primarily driven by the location of available wind resource.

We also believe Ofgem's position on Offshore transmission for wind farms, has not fully embraced the objective of a price control approach, namely to constrain the costs for all parties involved in the development of offshore wind farms, and to secure timely grid connections. Whilst Centrica supports the introduction of the non-exclusive common tender approach over the exclusive regime, the industry is not convinced that competitive tenders will bring about lower costs for developers in particular. The regime is also unlikely to solve supply chain constraints and costs that are hindering the development of many offshore projects. It is Centrica's view that Ofgem needs to be more proactive in delivering the new regime in a timely manner, whilst ensuring that developer's needs are being met.

In terms of administration of the RO Buy Out Fund, we consider that the principle of full transparency must be applied. For example, only costs which can be proved to be associated with the RO should be deducted. We believe that Ofgem's administration of the RO has improved since inception, however, we would like to see a review. Consideration should be given to whether SLAs should be applied to Ofgem in terms of dealing with queries and whether Suppliers & Generators should be able to appeal Ofgem's interpretation of the legislation.

Chapter 6: Helping to tackle fuel poverty

Question 1: Does this theme remain valid?

It is important for Ofgem to continue to build on its existing priorities around the tackling of fuel poverty, and for it to remain at the forefront of its strategy and plan.

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

We recognise Ofgem's intention to facilitate efforts of Government and Industry, but look to Ofgem to provide support where needed, championing issues such as the introduction of effective data sharing and access to benefits data, which will enable industry to target CERT

offers more effectively. We accept that suppliers have their part to play in tackling fuel poverty, suppliers cannot do this in isolation. Government has a role to play and we look to Ofgem to not only facilitate but also to actively champion such issues.

We welcome Ofgem's recognition of the contribution that suppliers are making and hope they will continue to encourage and incentivise suppliers to deliver real solutions.

Chapter 7: Better regulation

Question 1: Does this theme remain valid?

Centrica supports the principles of better regulation; Ofgem should continue to place them at the heart of their activities. Regulation should be proportionate to the maturity of the relevant market and the competitive pressures faced by participants. Where competition is effective, a far lighter touch is appropriate and efficient.

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

We would like to offer support for the proposed review of code governance arrangements and would refer to our previously submitted public response to the Ofgem letter. We agree that there are some issues. However, as with better regulation above, principles of proportionality and transparency should be carefully applied, particularly in the area of any actions identified. IN all cases, a proposed course of action should be tested against the risks, both in terms of cost and regulatory burden.

In addition, we refer to our previous responses in terms of transparency and information asymmetry. Where regulated monopoly companies exist in a regulated, price controlled environment, then the assumption must be in favour of publication of data unless in individual cases, exceptions can be justified. Where such justifications exist, they must be kept under review and tested on a regular basis to ensure they still hold.

In conclusion, we are generally supportive of the proposals. We believe that where adjustments are required, these are not insurmountable and will clearly benefit consumers.

Should you wish 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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