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16th January 2009

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Sent by e-mail to mark.feather@ofgem.gov.uk

Dear Mark

Re: Ofgem consultation on Charging Methodologies Governance Options

Please find attached a non confidential response on behalf of Centrica plc, (excluding Centrica Storage Ltd) in relation to the above consultation dated 17th September 2008.

1. Transmission and distribution charging methodologies that are used to derive network charges are of interest to all market participants and have a critical impact on the costs, incentives and information that users have at all levels of the market. As such industry participants and customers all have a strong interest in the methodologies operating efficiently and effectively. It is therefore self-evident that the present arrangements are inadequate. Our experience of dealing with the networks is that they are focused on their own business requirements and not those of their customers. The volatility passed through in charges to suppliers and the lack of action from the networks in proactively trying to assist users in having more visibility and predictability over future network charges all provides evidence of this.

2. Networks plan to spend £10 billion in the next 5 years to transform our energy networks. Against this background the case for reform is even more critical. Users and customers will ultimately pay for this expenditure. Yet remarkably those who pay will under the current governance framework have no direct influence or authority over how these costs will be charged back to them. This makes the current system unsustainable. It is increasingly recognised that users should have more influence, including rights of appeal. In its recent decision on BAA, the Competition Commission said that "We..... recommend that rights to appeal should extend to all parties with a sufficient interest, including airline customers and consumer bodies".¹ In the case of decisions imposing price control conditions, the CAT then refers any price control matters raised by the appeal to the CC for determination. This is analogous our case for increased influence by users over charging methodologies that determine how revenue set by those price controls is recovered.

3. This demonstrates that gas and electricity industry governance rules are in need of reform generally in this area. The current framework for charging methodologies as well as price controls does not provide for any formal rights or direct means of influence for the users who pay the charges. Therefore while the networks have a responsibility in their own right to consider how they interact effectively with their customers, it cannot be said that in these respects the regulatory framework is encouraging them to do so. For example in DNPC03, we believe the network owners saw commercial value in driving for an increase in the proportion of revenues recovered through capacity charges and hence pushed their proposals for reform with far greater urgency than they have others that appear to have no commercial value to them. This needs to change and this governance review is the right place for these reforms to start to happen.

Therefore Centrica views option 1 "do nothing" as unacceptable.

¹ The CC also observed that in relation to telecommunications networks and services, all affected persons now have a right of appeal on the merits under the Communications Act 2003 to the Competition Appeal Tribunal (CAT).

4. Option 2, stronger licence obligations upon network owners should be put in place irrespective of whether additional codification (Option 3) or a change management code (Option 4) are also introduced. This is because network owners need additional encouragement to ensure they provide the appropriate facilitating actions to enable those suggestions made by network users to progress

5. (Option 3) codification has merit and this would be an acceptable solution to us. We recognise that this may result in some additional administration costs, together with further volatility resulting from resultant increases in change proposals, however, given the importance of the charging methodologies to users, we do not believe these effects would be disproportionate.

6. Option 4, the introduction of a standard change management code for network owners would be a significant step forward. In our view the quality of engagement by network owners varies significantly. For example, we have frequently been advised of delays in completing analysis, developing proposals etc. because some network owners are waiting on others.

7. The potential administration costs associated with changes in this area will in our opinion be minor when compared to the value covered by such arrangements. Indeed we would not expect to recruit additional people to engage in such activity and believe other organisations will be in a similar position. Therefore additional costs to consumers should be minimal. The introduction of change windows could be applied such that change proposals were initiated, considered and implemented within set time windows to minimise costs and impacts. This, together with greater transparency in this area, will have significant benefits to network users and consumers, improving predictability and reducing regulatory uncertainty.

8. Our preference is that option 2 be implemented in conjunction with option 4 as this delivers the most benefits at the lowest cost. We would also be supportive of option 2 implemented in conjunction with option 3 as we believe that this would also deliver significant net benefits.

For the avoidance of doubt we strongly believe that reform should also include embedded, Offshore and independent transportation networks within its scope. Independent Gas transportation networks especially, lack transparency with ambiguity over what charges are and are not covered by charging methodologies.

We have attached as an appendix more detailed answers to your specific questions. If you require any further information or would like to discuss our response in more detail please do not hesitate to contact me on the above number.

Yours sincerely

Philip Davies
Director of Regulatory Affairs
British Gas

APPENDIX 1

Centrica response to specific questions

Chapter 2

Question 1: Are there other key issues that should be considered? If so what impact would these issues have on NWOs and network users?

1.1 Conflict of interests - Companies with supply and network businesses

Ofgem make no reference to the conflict of interest that can arise in those companies that have both a network and supply business. The potential for network businesses to adopt positions favourable to its supply business and vice versa is a major concern for Centrica. We were disappointed in the failure of the Brattle report to recognise this issue and to adequately distinguish between those positions adopted by suppliers with network business interests and those without.

We believe it would be appropriate for an additional level of rigour and transparency to be introduced to mitigate risks in this area. For example network companies with supply business interests should be required to support analysis that demonstrates the impact of change proposals initiated by them upon their supply business.

1.2 Charging arrangements excluded from regulatory oversight

There is a more general issue around those charges that presently escape appropriate regulatory oversight by Ofgem. For example independent gas transporters are imposing significant costs upon customers through their application of large charges for estimated readings but it is unclear on what basis if any Ofgem can act. In addition IGTs are now apparently able to make changes to their metering charges without any regulatory intervention, irrespective of the dominance that they hold in the provision of metering services on their networks.

Question 2: Are there any aspect of the key issues that we have not addressed?

In addition to network users being unable to propose new changes to charging methodologies, they are also unable to suggest alternative approaches to changes proposed by the network owners. As a result the innovation and creativity that might take place in shaping proposals is suppressed. For example the changes to capacity and commodity split centred around a move from 50:50 to 95:5, suppliers were not able to suggest alternatives such as a 70:30 split. This can leave Ofgem compelled to let pass a proposal that is better than status quo despite realising that more appropriate solutions could have been made available.

Question 3: Should Ofgem consider governance arrangements for all charging methodologies on a common timetable, or seek to prioritise? If the latter, which methodologies do you consider should take priority and what would the benefits of this approach be?

We believe that overall policy in this area should not be set on a piecemeal basis. However prioritising in terms of "implementation" would be worthwhile so long as it delivers the improvements needed sooner. The issues associated with Electricity transmission and distribution charges in our view warrant most immediate attention because of the value and present uncertainty associated with them.

Chapter 3

Question 1: Are there alternative governance arrangements that could be considered appropriate for charging methodologies?

We believe that Ofgem has identified the principle alternatives but note that more than one alternative can and should be introduced together. For example option 2 or at least facets of it shall be necessary in order for options 3 and 4 to be effective. Without proper incentives the network owners may not provide the appropriate facilitation / data that is required in order for changes to be properly developed.

Question 2: Do you agree with our assessment of the options against the principles of the review. Are there other impacts that we have not mentioned?

We broadly agree with Ofgem's assessment of the alternatives except with regard to cost effectiveness;

- The cost of administration is diminishingly small when compared to the value associated with transportation charges. It must be recognised that fairness and equitability of transportation charges are paramount and impacts on administration are a comparatively minor factor.
- Any concerns as to uncertainty / volatility can be easily mitigated via the introduction of set change windows or implementation periods together with improved transparency to enable users to predict effects.
- Greater transparency and improved governance should improve network users' ability to anticipate changes and reduce risk premiums.
- A high volume of change should only be expected if it is believed that there are many deficiencies in the present charging arrangements. If this is the case then it is a call to action in itself.

Question 3: What are your views on the cost and risk mitigation measures set out in this chapter? Are there other mitigation measures that could be introduced?

3.1 Annual or bi-annual windows for change and implementation

Centrica supports the introduction as the norm of windows for change and implementation, which would provide greater certainty and predictability of costs. We agree with Ofgem that there may be some circumstances when changes may warrant exceptional treatment because of the nature / value or urgency associated.

3.2 Annual restrictions on the number of changes

Centrica does not support a cap on the number of changes; this could have the effect of a cap on improvement. Moreover it is difficult to see how a cap could work in the event of changes being required in order to enable compliance with other obligations, for example cost reflectivity.

3.3 Modification proposal Thresholds for Users

Centrica believes it would be wholly inappropriate to introduce a mechanism that enabled users to suppress changes that are proposed by another user. Positions would likely be commercially based. It is highly probable that appropriate changes put forward by one user could be blocked by others simply for commercial reasons. We note Ofgem's suggestion that it could maintain some sort of decision making role. However it is unclear how this role could work if users were not able to raise their proposal in the 1st instance.

Cost Questionnaire for network users and customers

5. If you had the ability to raise modifications to charging methodologies how many would you have proposed within the last year?

Of all the network users we are often the most proactive and would expect to initiate in total between 3 and 4 modifications per annum spanning all charging methodologies. However it should be noted that many of these modifications would be common with those other network users may consider

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initiating as it is not uncommon for a number of suppliers to face similar commercial motivations for requiring change in a particular order.

6. In light of your answer to Question 5, please give an indication (as far as possible) of the costs associated with each of the governance options as set out in Chapter 3 in terms (where appropriate) of:

- Developing the proposal(s);
- Attending meetings and participating in the change process; and

Irrespective of which option is undertaken we do not anticipate increasing the present number of people engaged on this activity so in real terms increase in costs to Centrica and to consumers would be minimal.

The effort (per proposal) that existing resources expend on this activity would diminish the greater the number of proposals initiated. For example multiple proposals would often be discussed and developed either at the same meeting or at meeting scheduled on the same day. We note that any system costs would only be associated with those changes that needed implementation.

The table below shows the amount of effort in man days that we would anticipate for each option dependent upon different numbers of proposals initiated

	Option 2	Option 3	Option 4	Option 2 +3	Option 2 +4
1	5	10	7	8	4
2-5	8	15	12	12	6
6-10	10	20	15	16	8

We believe that combining option 2 with either options 3 or 4 will reduce the effort spent developing proposals because of the increased obligations upon network owners to provide facilitation

- The impact on your business in terms of charging price certainty, regulatory uncertainty and business investment.

Greater transparency combined with more ordered change and implementation windows shall in our opinion significantly increase price certainty and reduce the regulatory uncertainty that stems from the present regime