



Legal, Regulation and Compliance

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Thursday, 25 September 2008

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

Dear Andy,

Re: Ofgem Corporate Strategy 2009-2014 open letter

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, and we are happy that Ofgem place this response on their website and in the Ofgem library.

As always, Centrica welcomes the chance to input to Ofgem's Corporate Strategy and Plan for the next five years.

1. Themes and structure

Over the last several years Ofgem has considered its plan under seven topics, and these have generally provided an appropriate framework. However, we are concerned that the number of different topics may result in some fragmentation of effort or lack of holistic approach. Given this and the dynamic nature of the industry, Centrica believes it may be time to consider a review of these topics into three key themes or relationships, each having equal importance. We have set out our thoughts on these themes below, with two or three bullet points illustrating the likely areas of work under each.

- UK customers and citizens
 - Ensuring competitive markets
 - Safeguarding the interests of vulnerable customers
 - Helping to achieve sustainable development
- Essential systems & processes
 - Regulating infrastructure effectively
 - Improving industry & regulatory processes
- International
 - Developing the internal energy market in Europe
 - Protecting the security of Britain's energy supplies

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2. Key Strategic Areas

For the forthcoming corporate strategy and plan, we believe that Ofgem's priorities should continue to include key areas such as metering and price controls, but should also include some additional areas which we believe need greater prominence.

We have grouped issues into key strategic areas, each of which is considered in more detail below;

- Supplier Facing issues
- Process Improvement issues
- Efficient Network Development
- Relationship Management
- European/International issues
- Social Policy
- Energy Efficiency

2.1 *Supplier facing issues*

2.1.1 Smart Metering

The likely £8 billion rollout of Smart metering provides a fantastic opportunity to transform the industry model, delivering reducing costs and improved costs to consumers. However without the correct focus from Ofgem Smart metering could lead to more complexity, increased costs and poorer customer service. It is therefore imperative that Ofgem prioritise take leadership in this area. There must be a robust workplan for the implementation of smart metering and sufficient Ofgem resources committed to this critical area.

2.1.2 Theft

We now believe that theft represents as much as £500m cost to consumers every year. Whilst some work has been started to help reduce theft no progress has been made since 2005. This is unacceptable given the costs and risks to consumers. Stronger incentives must be put in place upon all parts of industry I&C as well as domestic suppliers.

2.1.3 Focused network regulation

We are encouraged with the approach that is being taken by Ofgem relating to the initial proposals for DPCR5 and by its review of price control pension principles. It is crucial that Ofgem steps up its scrutiny of DNO costs, given that the costs the networks seek to recoup must be incurred efficiently.

Ofgem's decision to introduce a common charging methodology across electricity distributors in 2010 is a significant step forward and will allow suppliers and other industry stakeholders to better predict their costs and reduce uncertainty.

The arrangements associated with Independent Gas Transporters place significant additional costs upon consumers. Whilst British Gas does not apply additional charges for consumers on IGT networks we agree that the additional costs of servicing these customers are as much as £50 per consumer. A total cost of up to £50million. Last year Ofgem committed to more focused regulation of IGTs. Some progress has been made by industry in developing modification proposals; however leadership is now required by Ofgem to resolve outstanding industry design issues.

2.1.4 Ensuring accurate targeting of costs

It is important that costs are allocated accurately, fairly and transparently. This places incentives in the right place and is most likely to result in a reduction of these costs and so result in benefits to consumers.

There are numerous areas where Ofgem can work with the industry to ensure that costs are accurately targeted, examples include; the allocation of gas imbalance costs, and new gas connections cross subsidy.

2.2 Process improvement issues

2.2.1 Transparency

Increasing transparency is essential; this has benefits under all three themes mentioned above and is a cross industry issue:

- Promotes and sustains competition
- Improves industry processes
- Sets a 'gold standard' for some other European jurisdictions where a persistent lack of transparency continues to hinder the development the internal market

Where it may genuinely not be possible to publish information, it is extremely important that Ofgem collects and uses that information in order to effectively regulate the networks.

To date, transparency issues have mainly focussed upon market activity. However, Centrica has also raised the issue of transparency around how the regulated companies are operating, for example on entry baselines and other areas of TO & SO operation. Perceptions exist that regulated companies may hold capability in reserve to enable them to respond to their incentives and maximise reward.

Clearly companies should be able to earn reasonable benefits for robust improvements under their incentive regimes, but without full transparency of operation, it is impossible to see how testing these regimes are.

2.2.2 Improving Industry Governance

The current Governance review is a significant piece of work for Ofgem and Centrica is supporting the industry activity in this area. We agree with the view that there is room for improvement, and see interesting opportunities for the industry in some of the proposals being made. However, a number of these proposals do have the potential to increase regulatory risk to participants and, if implemented, will need appropriate checks and balances.

The proposal for Ofgem to raise Issues Reviews is a case in point. Effectively giving Ofgem the ability both to propose and implement modifications will require robust complementary guidance rules on aspects of timely decision-making and code appeals.

We are supportive of increased self governance and would wish to see improvements in access to charging methodologies, including the scope for network users to propose changes.

2.3 Efficient Network Development

Clearly one of the more important areas for Ofgem is the efficient development of networks. As an industry we are driving towards greater "efficiency" in all the processes around Entry & Exit. However we believe that there is a significant chance of unintended consequences unless great care is taken to consider issues holistically, which is not always the case.

A good example is substitution of capacity. Centrica supports the principle of not investing where there is genuine redundancy that can be utilised. However, where this “spare” capacity is simply unsold, but may be utilised at a later date, substitution will lead to a tighter NTS, which in turn could have major consequences for commodity prices and hence for the interests of future consumers.

It is necessary to ensure that proposals and incentives around proposals are joined up, for example the recent discussions on Exit. The Exit proposals would allow GDNs to secure NTS flexibility as an alternate to investing in their own systems. Whilst this may be more efficient for an individual GDN this may not hold true for the system as a whole. Therefore an overview of the Price Controls is essential to ensure optimum investment in the total system and avoid any detrimental effect to the consumer.

It is clear that Distributed Generation will be a factor in delivering an efficient network and we believe that Ofgem may need to consider more radical innovations consistent with providing market rules and mechanisms that pro-actively support DG. There is a danger that in the interest of accelerating the growth of small scale generation projects, Ofgem may lose sight of value for money for consumers unless it keeps in mind the need to ensure that new incentives are subject to the same level of assessment and rigour as all other parts of the price control.

2.4 Relationship Management

2.4.1 External Relationship Management

Key external relationships include general industry stakeholders as well as with other Regulators, Government Departments and Competent Authorities.

Ofgem has shown good examples of positive interaction and dialogue with the industry in general, such as the recent engagement with industry on electricity charging methodologies, but unfortunately this is not always the case. Clearly, the regulator and regulated parties will not always agree, but we have been concerned to see indications that the constructive approach we have previously observed is deteriorating and less widespread than hitherto.

However we particularly welcome the recent change in approach by some Ofgem staff of sharing some of their thoughts earlier in industry discussions. We believe that this has been helpful, and hope this will continue.

In terms of Ofgem’s relationship with Government departments, the BERR guidance document helpfully illustrated this point. Where, for example, guidance exists but Ofgem identifies a potential conflict between its duties (whether primary or secondary) and policy, then Ofgem should automatically raise this issue at an early stage.

2.5 European/International Issues

We welcome the senior level engagement by Ofgem in this area but believe that Ofgem must re-energise at all levels and increase its commitment to facilitating a level playing field across Europe.

In terms of efforts on specific issues, full and effective input to BERR, ERGEG etc. on the detailed wording of the 3rd Package and on its subsequent implementation is both urgent and essential. Of particular importance are the arrangements for effective unbundling, the empowering of national regulators, the establishment of ACER and the creation of a framework for European market integration.

In the short term, this work involves support to UK Government representatives in Brussels and working to ensure the package achieves the intended improvements in continental markets, while avoiding any inadvertent implications for the markets in Great Britain.

For the short & medium term, it involves ensuring that ERGEG/ACER develops and pursues an aggressive and ambitious workplan for regional and European market development, focusing on the

priority areas which will support UK security of supply - in particular ensuring that codes and guidelines are well crafted and create a sound regulatory structure to underpin converging European markets and address obstacles to effective competition. Of critical importance in this work is the implementation of robust and harmonised frameworks information transparency, balancing and investment incentives (including open seasons). Ofgem should use its position in ERGEG to facilitate implementation of the current GGPs in these areas.

2.6 Social Policy

We expect Ofgem to continue to have due regard to supporting the more vulnerable consumers in society. However in fulfilling that obligation we expect Ofgem to recognise the complexities of the competitive market and the potential hazards of a “one size fits all” solution that promotes the perceived interest of some customers at the expense of incentives to innovate and customers more generally.

Fuel poverty is part of a wider problem of poverty and social exclusion caused by a combination of energy prices, low income and poor housing. As such the responsibility for tackling fuel poverty rests with Government. Whilst industry has a part to play in addressing these issues, it cannot be expected to deliver the solutions in isolation. In fulfilling its obligations, we would look to Ofgem (i) to protect consumers by recognising that diversity in a competitive market benefits the consumer and (ii) to champion the principles of a competitive market such that it avoids putting a disproportionate financial burden on suppliers to deliver.

We recognise the value of providing support to those customers that need it – our Essentials tariff is a tangible example where assistance is provided to the fuel poor and vulnerable customers in the form of tariff relief. However, in pursuing social tariffs as being one of the solutions of addressing the short terms impacts of fuel poverty, it is imperative that Ofgem considers the pricing diversity and product differentiation between companies and in doing so embraces the principles of a competitive market and customer choice.

2.7 Energy Efficiency

Ofgem has played a pivotal role in the delivery of the EEC1 and EEC2 Programmes and the early stages of CERT. The clear learning from these phases of the domestic energy efficiency obligation is that it needs to be as administratively simple as possible for both energy suppliers and Ofgem and the guidance reflect this. The current mechanisms for administering schemes are cumbersome with large unwieldy and inflexible spreadsheets; running the programme needs to be undertaken using more up to date technological solutions, particularly on-line.

Looking to the future (post the current CERT regime), it is important that the carbon emissions reduction obligation is integrated into wider carbon markets. Ofgem will be key to this, and where appropriate, administer any linkages between carbon reduction regimes (EU ETS, CRC) or provide validation of reductions obtained in a residential reduction regime which can then be used in other mechanisms perhaps for other sector targets.

We hope that these comments and general themes have been helpful. If you would like to discuss any of the points raised in more detail, I should be happy to help.

Yours sincerely,

By e-mail

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