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Dear Mark,

Re: Code Governance Review: Major Policy Reviews and Self Governance

Thank you for giving us the opportunity to respond to the work you are doing on the role of the industry codes and the way in which they are administered. This response is sent on behalf of the Centrica group of companies, excluding Centrica Storage Limited.

Summary

We support the objectives of this review and believe customers should benefit from improved arrangements. Well functioning governance is a critical part of a stable regulatory framework that promotes confidence in the market and without appropriate reform, for example including some of the proposals in this consultation, we agree there is a risk that future developments in the UK energy market could be hampered.

The Major Policy Review ("MPR") proposal for key strategic changes is a departure from the current arrangements and in order for it to be an effective and efficient way forward, there is a need for greater discussion on the details, for example, controls, definitions, scope, criteria for selection, powers to raise and balances. Sustainability and renewable energy targets are central to government policy at the moment and we recognise it will, in certain areas, be difficult to deliver well managed and coherent solutions under the current industry rules. For example, the necessary coordination to deliver major industry change across numerous codes such as Smart Metering is likely to be problematic without reform.

We have some concern over the timing and nature of appeals during the proposed MPR process. For example, the right to appeal to the Competition Commission is essential given greater Ofgem power to direct the process. Furthermore, we are of the opinion that the ability to decide when an MPR process should take place should not always be directed by Ofgem, and that there is value in allowing industry parties themselves to request an MPR. Also, we are not yet clear as to how an Ofgem direction to the relevant panel would sit with either panel members' duties to act independently or with the right of appeal to the Competition Appeals Tribunal (CAT) which subsists where the panel and Ofgem decisions differ.

We recognise the focus this consultation has on the MPR process, but want to stress that customers and market participants also need Paths 2 and 3 to operate more effectively, for example through better Ofgem or panel co-ordination when change is required across a variety of codes. We believe that consistent Ofgem engagement is

required to achieve this. An improved process, with greater Ofgem engagement, will reduce frustration as well as wasted time and effort. This will be of benefit to all, not only small, market participants.

We therefore strongly support Ofgem's proposals to allow the industry more scope to decide industry change on issues which have low consumer or market impacts. These modifications, whilst often technical and obscure are essential for the efficient and effective operation of industry codes, and any measure which improves the efficiency of the decision making process they are subject to is welcome.

The role of code administrators in each of the paths set out in Ofgem's proposals is vitally important, and we believe that this review should act as a catalyst for sharing best practice and improving performance. Code administrators should develop a Code of Practice to establish high level principles which participants can rely upon and then go on to share best practice and meet clear performance standards. These are themes which we have built upon further in our response to Ofgem's "*Code Governance review – role of code administrators and small participant/consumer initiatives*" consultation.

We believe the outcome of this project is very important, and are supportive of the general direction Ofgem is taking, subject to appropriate checks and balances being put in place. In particular, it is important to ensure the solutions adopted are proportionate and minimise any risks or unintended consequences associated with Ofgem taking on such potentially conflicting duties.

We understand that further consultation will follow on this subject as Ofgem's thinking is refined; this response therefore contains general principles rather than specific solutions. I have set these responses out below, broadly following the numbering within your consultation document.

2. Key issues and objectives.

Current industry codes have been largely successful at delivering incremental reform, however when these arrangements have been tested by large strategic change they have struggled. We agree with Ofgem's conclusion that a fragmented process can cause issues, and see the solution as being a process which allows large strategic policy decisions to be made in a co-ordinated fashion, with appropriate controls. This will be of particular benefit when implementing related change across a number of codes.

We therefore support the proposed three path approach outlined in Ofgem's consultation document, subject to more detailed proposals, and believe that when coupled with appropriate controls, it has the potential to deliver a framework which will in turn be capable of producing the change that the industry will need in the forthcoming years.

We believe Ofgem needs to do more in order to set out the controls that will be in place around the MPR process to prevent it from becoming the judge, jury and executioner on key issues. These controls are explored further below, but should include a right for industry parties to feed in to MPR thinking, and effective rights of appeal to the Competition Commission following the publication of MPR conclusions.

Furthermore, we believe the process needs appropriate safeguards to ensure issues of importance are not tied up for an indefinite length of time whilst a decision is made by Ofgem. An MPR process should, for example, include the agreement of a delivery plan at the very start so that all industry parties know when a decision on change can be expected, and who within Ofgem is responsible for that decision.

We strongly support Ofgem's intention to increase the degree to which the industry can self govern, and believe that this will expedite the implementation of change which is fundamental for the effective operation of the codes themselves, and are therefore integral to the operation of the market.

It is not an appropriate use of Ofgem resource to consider the merits of some of the more technical changes, the effect of which would be to restrict Ofgem from spending time considering the strategically important issues, and delaying the much needed lower level change the industry requires to operate effectively. The proposals for a "Path 3" approach is therefore welcomed, subject to further detail on the criteria used to determine which changes follow this route.

Finally, we support Ofgem's proposal that these new processes should apply to all codes, and think that to do otherwise would negate the benefits derived from homogenous processes. We would need to be convinced of the business case for any different solution.

3. Filtering Criteria.

We recognise the need for a process to determine which of the three paths a particular change should take, and have a strong preference for Option B; "*Industry allocates modifications with Ofgem veto over decision*".

This option will allow for panels or the change originator to make a decision at the point of raising the modification, report that decision to Ofgem and then proceed immediately with the assessment of that modification, reducing the amount of time it will take to progress change.

If Ofgem disagreed with the decision made by the panel or change originator then it is right that they should have the ability to "call back" the modification, for example to the MPR process. As discussed below however, we believe this decision should be appealable if an industry party feels that the Ofgem decision did not meet the criteria set out for the assessment of which path a change should take.

The alternative option of Ofgem allocating the modification to a path themselves will negate much of the benefit industry will gain from this process. Large amounts of Ofgem resource will be used in order to make decisions which can better be made by the relevant panel or change originator, slowing the modification process down whilst a decision is awaited.

It is also possible that during the filtering process, industry parties and panels may identify issues which they believe may warrant an MPR. We therefore believe it necessary that industry parties and panels should be able to feed their request back up the line for Ofgem to consider instigating an MPR.

Regardless of the option ultimately chosen here, it is imperative that the industry has an effective right of appeal over the decision taken. Whilst there exists a general right of appeal relating to the qualitative decision made on the modification at hand, the decision made as to which path a modification should take has fundamental implications for the time, resource and cost it will take in order to progress a modification. It should also therefore be appealable.

Finally we would like to understand more about Ofgem's proposals relating to the suggested moratorium on further change proposals being raised during the MPR process. We have concerns that this may hamper the development of important modifications which may quite reasonably be raised during the wide ranging discussions of an MPR. Whilst we understand the rationale behind the suggested moratorium, we believe that these concerns could be addressed by Ofgem specifying the criteria under which modifications could acceptably be raised.

4. Major Policy Review.

As discussed above, we support the need for an MPR process, and believe that it could be a constructive part of the change processes used to develop the solutions required for strategic change in the UK energy market in the coming years.

Whilst we agree that Ofgem should be able to initiate an MPR, we believe there is merit in allowing industry parties themselves to request the appropriate panel to also initiate an MPR. They are often best placed to identify the emerging issues which will ultimately necessitate an MPR, and are well positioned to identify when important modifications are becoming stuck within industry code processes.

Once an MPR is completed, we believe the most effective and efficient way in which to progress the resulting modifications will be for panels to decide how best to implement the results within their particular code. Furthermore, we would welcome some discussion about the potential disconnect between Ofgem decisions as a result of MPR processes and panel members' duties, as well as rights of appeal. Each code differs to a large extent in both form and function, and we are of the opinion that a more centralised, Ofgem led, approach to policy implementation will be both more time consuming and likely to deliver results which do not meet the intended goals. We therefore support "*Option 1 – High level binding conclusions*" as the most appropriate way forward, coupled with a right for Ofgem to review the final output, as they would do under Path 2, so that they can ensure they are satisfied with the end result.

This approach would use resource in the most efficient way; panels would be tasked with resourcing the development of the final proposals, producing legal text and seeing through the implementation of the various modifications, all of which we consider would be an inappropriate use of Ofgem resource.

Finally we agree that MPRs should not follow a “one size fits all” approach but believe that some fundamental principles should be agreed during this consultation process. For example, we strongly believe that Ofgem should commit to providing an opportunity for industry parties to feed in to all MPR processes through consultations, workshops, open fora and other consultative tool.

We also consider that industry parties’ rights of appeal should be enshrined as part of this process. For example, it would be appropriate for industry parties to appeal both the decision reached as part of the MPR process, and also the decision reached on the method of implementation. Currently if there is no right of appeal following the release of the MPR conclusions, it will not be possible to subsequently appeal against the resulting panel modifications. If parties do not have a right of appeal on the final decision reached by panels on the method of implementation, the fact that the conclusion does not differ to the Ofgem direction will automatically rule out an appeal right.

Finally, we do not believe that there is a requirement for Ofgem to take backstop powers as described in paragraph 4.22.

5. Proposed “Self Governance” process.

We support the principle of greater self-governance and believe that this will deliver significant benefits, both in terms reducing the amount of time it takes to progress simple modifications, and by utilising industry and Ofgem resource in a more efficient manner.

We recognise some improvements may be needed to the constitution of some industry codes in order to facilitate the proposed self governance process, and have commented on these changes in our response to the Ofgem consultation “*Code Governance review – role of code administrators and small participant/consumer initiatives*”.

We do however think there is the need for changes under Path 3 to be able to be “sent back” to path 2, and agree that Ofgem should have a right to do this during the modification process should they see fit. We also believe industry parties themselves may identify the need for a modification to move from one path to another, and that the process Ofgem eventually decide upon should therefore allow for a two-way process where both Ofgem and industry parties can send modifications back to Path 2.

Finally, we agree that the normal appeal rights of industry parties under Path 3 should remain, and see no reason why these rights should be different to any other modification type. For example, we would not support an automatic right of appeal to only one group of parties or the removal of an existing right of appeal.

Other Issues; “Path 2 - Improved Status Quo”.

We recognise the need for a process akin to the one currently used to assess modifications, and agree with Ofgem that work needs to be done to reform the current arrangements. We believe the majority of change will go through this path and therefore consider it to be vitally important that it functions properly.

We recognise that Ofgem have proposed some general reform under their consultation “*Code Governance review – role of code administrators and small participant/consumer initiatives*”, but would welcome further discussion on the improvements that are required.

In particular we want to discuss how we can improve the quality of Ofgem involvement throughout the process, increase the impartiality of code panels, and reduce the degree to which the difference between codes and licences have to navigated.

Conclusions

1. We support both the objectives of this review, and the general direction Ofgem is taking. We would however welcome further discussion on the controls that will need to be in place in order for this new process to be effective.
2. We support the principle of the proposed MPR process, subject to more detail on the specific controls that will be in place to prevent Ofgem from becoming the judge, jury and executioner. Specifically we would welcome further discussion on appeal rights immediately following the publication of an MPR’s conclusions and how enshrine the right of industry parties to feed in to an MPR process.

3. We believe that panels themselves are best placed to decide upon how change is implemented, and urge Ofgem to steer clear from controlling too much of the process for progressing MPR findings. We consider that it sufficient for Ofgem to have a veto over the resulting modifications.
4. We recognise the need for an improved status quo change path, but want to highlight the importance of getting this right, and therefore of working out the details for reform. We would welcome further discussion on the improvements which are necessary to make this path work.
5. We support Ofgem's commitment to increasing the degree to which the industry can determine its own affairs, but want to stress that this will only deliver the expected benefits if done in conjunction with the reform of the status quo approach.

We are happy for this response to be published within Ofgem's library and website. Should you wish to discuss any of the points raised in this response, please do not hesitate to telephone me on 07789 570501.

Yours sincerely

David Watson
Regulatory Manager