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Mark Cox
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Ofgem
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12th May 2010

Dear Mark

RE: Code Governance Review - Final Proposals, Licence Drafting and Code of Practice Consultations

1. British Gas has been an advocate of the objectives of the governance review since its inception. We have been particularly active in calling for a range of measures that improve the governance of industry codes and increase the influence of suppliers over network charging arrangements,
2. We are therefore delighted that Ofgem has recognised the growing need for energy suppliers to have more influence over network charging arrangements. We spend over £2.2billion in network charges every year, accounting for 28% of domestic customer electricity bills, and 22% domestic customer gas bills. For energy suppliers to have such limited influence over how these charges are levied on them and their customers is no longer acceptable. Ofgem's plan. Therefore represents a welcome modernisation of the governance regime
3. Network charges are increasing and at the same time the relationship between networks and suppliers is developing, with for example the development of smart grids. Therefore providing for increased transparency and legitimacy of these charging arrangements is crucial. We are particularly pleased that;
 - Ofgem has agreed to place an obligation upon on networks to provide the information necessary for Users to propose changes. This obligation in the proposed licence conditions ensures that reform in this area will be effective. It also gives suppliers some prospect of resolving issues they face with the networks today.
 - A three-month change window for initiation of charging methodology modifications will be implemented. This will help mitigate any potential volatility that could arise from the ability of a wider range of industry parties to initiate change. This could be co-ordinated such that it worked with the existing price change cycle.
 - Gas distribution methodologies are to be included within the scope of this reform from the outset, in addition to transmission. As we have previously stated, Gas Distribution costs represent £2.8billion, or approximately 15% of a consumer's bill. Without this clear signal from Ofgem on the timetable for change we believe that reform to these methodologies may have stalled.

4. We are concerned however that network owners may have an incentive to seek approval of charging modification proposals in advance of a new regime being introduced. It is clear that the existing arrangements are advantageous to network owners, a point made obvious by their resistance to change. With this in mind Ofgem should instruct network owners to delay any charging methodology proposals until after this new regime has been implemented. This would allow the benefits of the new regime to be applied to such proposals and remove the incentives for networks to propose changes now to beat the deadline for cutover to the new regime.
5. We have been fully supportive of the principles of the Code Governance Review but while we are pleased that Ofgem wishes to complete implementation by Autumn 2010, we believe that this may not be practical for all aspects of the proposals. Our industry will increasingly be tasked with introducing change such that government policy can be implemented. Smart Metering is an obvious example where without change to our industry governance arrangements the delivery of the change necessary to implement government policy will be almost impossible. We agree with the proposals for the Significant Code Reviews (SCR) and self-governance save for the following significant and outstanding concerns;
 - Ofgem must set out the process through which a topic will be chosen for an SCR, how the pathway for industry change will be determined and how Ofgem will undertake to have effective consultation during each SCR. This will enable industry parties to understand exactly how the reform of key strategic issues will be dealt with as they make investment decisions, and enable them to feed in their views on the direction of change.
 - Ofgem has not yet addressed the problem created by the current restriction on the ability to appeal an Ofgem modification decision following an SCR, contained within section 4 of The Electricity and Gas Appeals (Designation and Exclusion) Order 2005. Ofgem is proposing that they have the right to call an SCR, to have the final say on the recommendations of that SCR, to obligate parties to raise a modification enacting those recommendations and then to act as decision maker on those modifications. If parties are to have an effective control on this power, they must be able to appeal Ofgem decisions to accept modification proposals.
 - In respect of moving governance of the charging methodologies into the codes, for example into the CUSC, we believe that more time may be needed to consider the proposals and draft robust legal text to ensure the changes are fully effective. We do not believe that an implementation date of 1st November 2010 would enable charging changes to be implemented for April 2011 and therefore see no reason why the necessary time cannot be taken.
6. However, we would not wish to see unnecessary delay to other parts of the proposals and, in terms of implementation we suggest that the SCR and code governance proposals are prioritised for implementation in November 2010 as proposed. This is basic critical path management that will enable our industry to balance the need to ensure the more straightforward aspects of these urgent reforms are not delayed unnecessarily.
7. Attached as an appendix are additional more detailed comments together with some further elaboration on the above points. If you require additional information or would like to discuss this further please contact me on the above number.

Yours sincerely

David Watson
Regulatory Manager, British Gas

Appendix - Additional Detailed comments

Licence Drafting

1. We believe that the proposed licence drafting will achieve what Ofgem has set out to do, and should have no unintended consequences.

Code Governance Review – Final Proposals

2. We have previously requested that Ofgem do more to document the process and procedures which will dictate how the SCR process will operate in practice and how individual parties' rights will be guaranteed. For example, it is essential that Ofgem set out in advance of the formal licence drafting how a topic will be chosen for an SCR, how the pathway for industry change will be determined, under what circumstances will Ofgem exercise the proposed backstop powers and how Ofgem will undertake to have effective consultation during each SCR. These points are expanded on further in our response to Andrew McFaul on Ofgem's initial proposals, dated 18th September, but are vital if parties are to have confidence that the process has the sufficient controls within it to make it work effectively.
3. Whilst we remain supportive of the SCR proposals, we continue to believe that Ofgem should set out the process through which a topic will be chosen for an SCR, how the pathway for industry change will be determined and how Ofgem will undertake to have effective consultation during each SCR.
4. We are concerned that Ofgem has not yet addressed the problem created by the current restriction on the ability to appeal an Ofgem modification decision following an SCR, contained within section 4 of The Electricity and Gas Appeals (Designation and Exclusion) Order 2005. Ofgem is proposing that they have the right to call an SCR, to have the final say on the recommendations of that SCR, to obligate parties to raise a modification enacting those recommendations and then to act as decision maker on those modifications. If parties are to have an effective control on this power, they must be able to appeal Ofgem decisions to accept modification proposals.
5. We understand the reasons behind the decision to change the definition of what is a "small" participant, but believe that the current definition could mean that some of the largest energy companies in the world by market capitalisation are provided with support from code administrators at the expense of other market participants. This perverse outcome can perhaps be resolved by Ofgem providing the Code Administrators with guidance on how to apply the definition in practice.
6. We are pleased that Ofgem have confirmed that if a party is obliged by them to raise a modification following an SCR, their eventual rights of appeal are not fettered. This is an important tool in ensuring parties are not disenfranchised during the SCR process, and serves to emphasise the points we make in paragraph 4, above.

Code of Practice

7. We support a Code of Practice and we also agree with the broad principles which are set out in your recent letter. However we do not believe that this will significantly aid the understanding of industry codes within new market entrants, nor will it lead to a marked increase in their engagement with those Codes.
8. Furthermore, we have some concern regarding some of the Key Performance Indicators (KPIs) and believe that they may lead to the gathering of data which will be of little use, or worse still, may lead Code Administrators towards unwelcome or unhelpful behaviours. These concerns were discussed in more detail at the workshop which was held on 29th April.

9. We believe that it will be important to keep both the Codes of Practice and the associated KPIs under review to ensure that they are meeting the objectives which Ofgem has set out. If it ultimately proves that they are not adding any value to the industry governance arrangements, we would expect for them to be either amended so that they do add value, or removed completely.