Consumer Focus
Campaigning for a fair deal

27 September 2010

Mark Cox
Ofgem
9 Millbank
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Dear Mark,

Response to consultation on potential significant code reviews

Thank you for providing us with an opportunity to respond to your consultation on potential candidates for significant code reviews ('SCRs'). This response is entirely non-confidential and may be published on your website.

The introduction of SCRs

We welcome the introduction of SCRs. While the majority of proposals to alter the industry codes will take the form of incremental changes to existing arrangements there has long been a need for a vehicle that will allow more fundamental changes to be considered in a holistic and rounded fashion.

We also welcome the transparent and open manner in which you are consulting on potential candidates for this route. The candidates, and their relative priority, are likely to change over time as the strategic priorities of the industry do. We therefore encourage you to look at ways to periodically refresh the list, seeking the views of stakeholders as you do so.

On a cautionary note, we encourage you to use SCRs sparingly rather than as an everyday tool. Energy policy is a boom industry; and a large number of major policy initiatives by either government or regulator are already underway – or slated for launch in autumn 2010. We are worried that you appear to be envisioning three SCRs running in parallel from this autumn. Your stakeholders, both consumer and industry, may struggle to cope with this volume of major initiatives inserted in to an already packed to-do list.

Good policy is founded on decent evidence and consultation; and a pre-requisite for both is adequate engagement. The timing and prioritisation of projects clearly affects this and, in the event that you decide to run multiple SCRs, we would strongly encourage you to consider whether the timing of these can be staggered or otherwise co-ordinated in a way to avoid exacerbating existing bottlenecks.

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The candidates for review

We have the following observations on the three candidates for SCR that you identify.

Gas security of supply

We support a review of the gas security of supply arrangements; this is timely given the government's view that this area needs attention.

We particularly welcome the suggestion that the SCR should consider compensation mechanisms for firm customers cut off. This is an overdue debate; large consumers are understandably worried about the financial consequences of being cut off and current perceptions of this risk may well be a contributory factor to the clamour from some lobbyists for the introduction of strategic gas storage obligations (i.e. as insurance against this risk). We do not rule out the possibility that additional gas storage may be necessary, but before investing in assets it seems sensible to see whether products can solve the problem more cheaply.

We are mindful of your current work on the avoided costs of investment that could be driven by demand side response[1], and of DECC's analysis of gas security of supply[2], both of which suggest that there may be value in looking at the scope and availability of interruptible (or otherwise flexible) products as a means to help secure supplies – and to reward those companies able and willing to provide these services.

Electricity cash-out

We do not support a review of the electricity cash-out arrangements at this time. This is not based on any philosophical objection to the notion of moving to fully marginal, or otherwise sharper, cash-out signals – but because we question the practical wisdom of attempting to do so until wholesale market liquidity problems have been adequately resolved.

Back in March, responding to the consultation on Project Discovery policy options[3], we noted that:

> *'careful thought will need to be given to ensure that any policy interventions do not simply create problems as large as the ones they replace'*

before going on to state that:

> *'We see logic in the desire to strengthen price signals to encourage investment in peaking plant. The benefits of this are obvious, although the impact of changes to market rules on the competitive dynamic should be taken in to account.*

[1] http://www.ofgem.gov.uk/Sustainability/Documents1/DSR%20150710.pdf
[2] http://www.decc.gov.uk/assets/decc/what%20we%20do/uk%20energy%20supply/energy%20markets/gas_markets/114-poyry-gb.pdf
[3] http://www.consumerfocus.org.uk/assets/1/files/2009/06/Consumer-Focus-response-to-Ofgems-consultation-on-Project-Discovery-policy-options-FINAL.pdf

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[...] liquid wholesale markets are an essential companion to strengthened price signals. There is no point sending out stronger signals on market participants to forward contract if there is no mechanism through which they can do this.

The state of liquidity in the gas wholesale markets is adequate for the purpose of forward contracting. In electricity, it is dismal. We would encourage you to prioritise consideration of price signals in gas before you look at electricity. Sharpened price signals in electricity should only be considered when you have come up with a credible solution to the illiquidity in that wholesale market. If the former is tackled without the latter, you may simply end up killing off what little competitive fringe exists in that market.'

We see nothing in subsequent events to dissuade us from retaining that view. It does not appear to us that you are now materially nearer to solving wholesale power market illiquidity than you were at that time, and we find it hard to have confidence that you will have done so in time to meet the SCR timetable you propose. We do not, and could not, support an SCR on electricity cash-out until meaningful progress is made on wholesale power market liquidity.

Smart metering

Of the three candidates you identify, smart metering is probably most conducive to a significant code review. This is because unlike electricity cash-out and gas emergency arrangements any changes identified for smart metering are likely to affect multiple codes and both fuels. Indeed, it is possible that they may even necessitate (a) new code(s). The normal code modification processes, which restrict proposed changes to a single code (on a single fuel) at a time, are likely to struggle given this complexity.

The way forward

We hope you find this response helpful. If you have any questions in relation to our views on smart metering please contact Zoe McLeod on 020 7799 7973, for any questions on our views on the other candidates or the general approach to SCRs please contact me on 020 7799 8042.

Yours sincerely,

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