

Joanna Wittington
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23 August 2013

Dear Joanna,

Pricing Benchmarks in Gas and Electricity Markets – a call for evidence

I am writing to provide you with some of our views on the regulatory framework for pricing benchmarks, following some earlier discussions you held with Philip Davies on 30 July, and also in response to the above consultation.

We recognise that, particularly in the light of recent revelations on LIBOR, governments and regulators have shown a great interest in seeking to ensure that pricing benchmarks are reflective of market activity and operate with strong levels of integrity.

Price assessments remain a valuable tool for business. Some European gas and power markets are only recently starting to exhibit higher levels of liquidity as the impacts of market liberalisation take hold. Market liberalisation offers greater opportunities for increased efficiency in the operation of the supply chain where consumers are one of the main beneficiaries. However, to take full advantage of these improvements, companies need the ability to manage and optimise positions through commercial transactions, including traded markets that exhibit price transparency.

In evolving markets, a variety of participants are necessary to create sufficient trading liquidity to support commercial transactions. The price reporting agencies (PRAs) are an essential part of this activity, particularly in new product or geographical areas where exchange-based trading, or trading on established bilateral OTC trading platforms, is non-existent or in its infancy. PRA methodologies should be transparent and subject to appropriate levels of governance in order to improve market trust and confidence. We understand that the IOSCO work in this area has been broadly welcomed.

In the energy markets, we see no inherent flaws in the overall data feeding into the gas and power benchmark prices across the main markets in Europe, whether it has arisen from exchange-based trading or through OTC trading activity reported to PRAs.

That said, in our view, there is room for the PRAs to evolve, in conjunction with maturing markets and technological developments, towards more objective price calculations and away from PRA price assessments.

For example, in our 9 August response to Ofgem's wholesale power market liquidity document, we proposed an alternative approach on market-making where all obligated parties would be required to

market-make in a defined trading window at the end of each trading day, subject to suitable circuit-breaker provisions being in place that apply in situations where it is difficult to market-make. This approach would make the operations of the scheme much more predictable and reliable for market participants. It would also make it easier to compute robust price indices by guaranteeing a baseline level of liquidity in a short daily trading window.

This approach is consistent with our view that automated and mechanical trade-based processes, which contribute to calculating arithmetically-derived price indices, should be preferred to price assessments wherever possible.

With regard to PRA interactions, Centrica does not permit its front office staff to provide price assessment data to PRAs. This avoids putting Centrica's traders in a position of a potential conflict of interest with respect to their trading positions.

We believe that any new regulatory measures requiring mandatory reporting to PRAs would add significant operational risk for marginal or non-existent gains in market transparency.

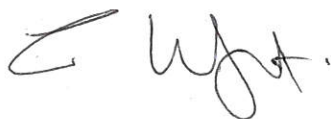
Further, should such mandatory reporting measures to PRAs be considered necessary, we believe that there would need to be appropriate 'safe harbour'-type rules put in place for companies submitting data to PRAs. Such safe harbour provisions would afford protection from penalty or liability where the conditions prescribed in the safe harbour have been fully satisfied. Such safe harbour provisions could, by way of example, include the technical data submission processes which, if followed, would avoid individual or corporate penalty or liability, should the data submissions to PRAs be inaccurate. Submitting price assessment data to PRAs may become an even more relevant consideration for market participants, under the application of REMIT and MAD(2)'s market abuse rules, when they consider their role in submitting price assessment data to PRAs in conjunction with the increasing scrutiny of their overall market conduct in interacting with the energy markets.

We agree with Ofgem that it is not entirely clear where the responsibility for any greater level of regulation for price benchmarks would fall. However, if more proscriptive regulation is applied (as per the new UK rules on LIBOR) for systemically important benchmarks, then we have a preference for a single regulator to take charge, rather than a sector-based approach.

I trust that this information will be useful to Ofgem as it considers its next steps.

If you have any questions about this response please feel free to contact me by email at Adam.Cooper1@Centrica.com or by phone on +44 (0)7557614458.

Yours sincerely,



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