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Sent via e-mail: pmg@ofgem.gov.uk

Dear Keith

Ofgem's Forward Work Programme 2016-17

Thank you for the opportunity to comment on Ofgem's draft Forward Work Programme (FWP) for 2016-17. This response is submitted on behalf of the Centrica group, with the exception of Centrica Storage.

Centrica welcomes the visibility of Ofgem's activities that the FWP provides, and the contribution it makes to a predictable regulatory regime. As well as helping the industry to plan resources and raise any concerns, the FWP enables stakeholders to identify opportunities to work with Ofgem to improve outcomes for customers. Centrica is keen to have an open and constructive dialogue with Ofgem on all matters.

Ofgem's FWP is wide-ranging. Our response focuses on those areas where we have clear proposals for how Ofgem could improve its practices and plans. We also express our support for a number of Ofgem's strategic projects.

We have grouped our comments under five themes:

- Future of Retail Regulation
- Enhancing competition
- Security of Supply
- Improving regulation
- Minimising burdens

We hope that Ofgem will consider our proposals and explain how it took them into account when it publishes its final FWP.

Future of Retail Regulation (FRR)

We support Ofgem's proposal to move from a reliance on prescriptive rules towards principles-based rules in the domestic retail market. We believe that principles can better promote competition and protect consumers in some important ways, for example:

- Principles are more flexible than prescription so they should allow suppliers to innovate and do things differently
- Principles place more responsibility on suppliers to determine the right thing to do

We believe that suppliers and Ofgem may need to make some important changes to their culture and practices in order to attain the potential benefits of a principles-based approach. For example:

- Suppliers should be prepared to be open with Ofgem on what they are doing, and why, to deliver good customer outcomes
- Ofgem should be prepared to accept that suppliers will do things differently to meet the same principle, and that difference is healthy in a competitive market

The catalyst to making these changes happen is mutual confidence. As a supplier, we believe that we need to demonstrate that we are committed to doing the right thing and have appropriate structures and processes in place to achieve that. Ofgem also has a part to play. We will provide detailed views on Ofgem's proposed approach in response to the FRR consultation.

At this stage we would like to highlight two immediate opportunities for Ofgem to inspire more confidence in the shift to a principles-based approach to regulation:

- **Principles first.** During the transition to principles, we believe that Ofgem should consider principles first in all regulatory initiatives and avoid prescription that does not fit with the wider FRR approach. We recognise that Ofgem looked at principles in its work on smart billing and the Priority Services Register (PSR). But we believe that its smart billing and PSR proposals could have been even more principles-based.
- **'General fairness' and 'Standards of Conduct (SOC) fairness'.** We urge Ofgem to pay close attention to its use of the term 'fairness' when referring to supplier behaviour it observes or would like to see. We believe that sometimes Ofgem has used the term 'fairness' in a way that wrongly implies that the SOC (a) apply, (b) prescribe a specific behaviour or (c) prescribe a standardised behaviour across suppliers. For instance, Ofgem is currently questioning the 'fairness' of collecting debt recovery costs from customers who give rise to them¹.

Enhancing competition

- **Reliable next-day switching.** We would like to reiterate our support for Ofgem's Change of Supplier (CoS) Reform programme. We are excited about the potential that faster switching has to promote consumer engagement and enhance competition. CoS Reform is a very significant project that will require buy in from stakeholders across the industry. British Gas is ready to play its part in helping to

¹ https://www.ofgem.gov.uk/sites/default/files/docs/final_consultation_ppm_0.pdf

ensure that changes are delivered in a timely way, whilst minimising costs to consumers and not compromising on reliability. We are already engaging in the various programme groups in earnest.

- **Reflecting on the CMA's views of Ofgem's past interventions.** We believe that an important omission from the FWP is an Ofgem workstream to reflect on the CMA's Provisional Findings and Final Report regarding Ofgem's past interventions. For instance, in its Provisional Findings the CMA stated that 'some of the RMR measures...may have an adverse impact on competition and consumer welfare'². If Ofgem agrees with the CMA's view of Ofgem's past interventions then we believe Ofgem should review why these interventions occurred and consider what changes it needs to make to its ways of working.
- **Doing more to facilitate innovation in the short term.** The move to principles-based regulation should create more room for suppliers to innovate. But the removal of prescriptive rules from the licence, whether by Ofgem or the CMA, will take time. To speed up when customers can benefit from innovation, we believe that Ofgem should provide flexibility around prescriptive rules before they are removed or reformed, and allow suppliers to carry out trials in a responsible way. The Financial Conduct Authority (FCA)'s use of principles appears to be a less bureaucratic way of facilitating trials than the Ofgem derogation process. We have suggested some principles that Ofgem might use to facilitate trials in our response to Ofgem's Simplification Plan. We welcome Ofgem's confirmation that it 'will build on existing innovation programmes to develop new approaches to support innovation and the safe testing of new products and services'³. We look forward to learning what these new initiatives are.
- **Only publishing data that is accurate and helps consumers.** We were pleased that Ofgem consulted on which customer service indicators it wanted to publish and why in July 2015. We are pleased that Ofgem is proposing to consult on the future of the Supply Market Indicator (SMI). As part of the consultation on the SMI we urge Ofgem to clearly set out the policy objective it is seeking to achieve. We do not believe that Ofgem should publish any forward looking estimate of supplier costs or revenues because such estimates will inevitably be inaccurate and could have detrimental impacts on competition. We also believe that the provision of any estimated 'margin' figure or ability to 'derive' it by subtracting costs from revenues will likely be misrepresented as actual profit. The Consolidated Segmental Statements (CSS) already provide an accurate view of actual costs and revenues across the largest vertically integrated companies.
- **Favouring cost reflectivity and avoiding redistribution of costs among consumers.** We support Ofgem's statement that it is not for it as 'an independent regulator to initiate or pursue a policy to achieve social or environmental outcomes which has the purpose of levying significant costs, or seeking significant redistribution of costs among consumers'⁴. We believe that Ofgem should be more mindful of this commitment when developing policy proposals. To illustrate our concern, Ofgem does not appear have fully acknowledged the distributional consequences of its current PPM proposals⁵. Ofgem has not stated what the

² https://assets.digital.cabinetoffice.gov.uk/media/559fb629ed915d1595000038/Appendix_8.2_Impact_of_RMR.pdf

³ https://www.ofgem.gov.uk/system/files/docs/2016/02/fwp_2016-17.pdf Paragraph 2.13

⁴ https://www.ofgem.gov.uk/sites/default/files/docs/2014/12/corporate_strategy_0.pdf p. 11

⁵ https://www.ofgem.gov.uk/sites/default/files/docs/final_consultation_ppm_0.pdf

distributional consequences are and it has not done a quantitative Impact Assessment (IA).

- **Issues with Ofgem's consumer insights programme.** Without further detail we do not support Ofgem's plans to 'advance [its] work on behavioural insights'⁶. Many of Ofgem's Retail Market Review (RMR) interventions were informed by behavioural insights and the CMA believes that the simpler choices elements of RMR are likely to have caused an adverse effect on competition. We also have reservations about Ofgem's plans to do 'more innovative, diverse and ambitious consumer research'⁷ because Ofgem has not said why it wants to do it. We had understood that a greater reliance on principles would involve fewer prescriptive interventions in future. We would be concerned if Ofgem's consumer research programme instigated the types of prescriptive interventions that have caused problems in the past.
- **Monitoring the impact of the Secure and Promote licence condition.** The ultimate deliverable from Ofgem's planned monitoring of wholesale power market liquidity is unclear from the FWP. We suggest that Ofgem should carry out a thorough review of the impact of the Secure and Promote licence condition, ahead of its third anniversary in March 2017.
- **More visibility of actions in the Flexibility Strategy.** Paragraph 2.8 of the FWP sets out the arrangements Ofgem thinks might need to change to cater for more intermittent and distributed generation on the electricity system, and to minimise grid investment costs. We look forward to seeing more detail on how it will adopt a joined-up strategic approach when it provides an update in the spring. We ask that Ofgem adopts the objectives of encouraging market-driven innovation and ensuring that cost impacts fall where they arise.

Security of Supply

We believe that Security of Supply in electricity (paragraph 4.8 of the FWP) deserves more emphasis in the Deliverables section of the FWP, given the significance of the issue. Whilst Government is leading on the current Capacity Market review, Ofgem will play an important role in administering and enforcing the new Capacity Market rules. Ofgem will also need to work with National Grid Electricity Transmission (NGET) to determine the interim Supplemental Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR) measures that will be required for the 2016/17 winter and the following year.

Improving regulation

We are pleased that Ofgem has established an 'Improving Regulation' division. We believe that this division should focus on achieving a consistently high standard of regulation across Ofgem. It can do this by embedding best practice processes and economic analysis as standard. To this end we are pleased that Ofgem has set up a new analytical excellence team to provide 'central analytical support'⁸. We hope this will mean that policy, monitoring and enforcement teams will have greater access to economic expertise.

⁶ https://www.ofgem.gov.uk/system/files/docs/2016/02/fwp_2016-17.pdf paragraph 3.10

⁷ https://www.ofgem.gov.uk/system/files/docs/2016/02/fwp_2016-17.pdf paragraph 3.9

⁸ https://www.ofgem.gov.uk/system/files/docs/2016/02/fwp_2016-17.pdf paragraph 7.13

We have reservations about the analytical excellence team setting out ‘regulatory stances for use by staff’ because we are unsure what ‘regulatory stances’ means. If ‘regulatory stances’ means ‘policy positions’ then Ofgem should be transparent about what they are and consult on them.

We would like to make ten proposals that we believe will improve regulation across Ofgem if it adopted them. We have listed these proposals and our rationale in the table below. We believe that it is within Ofgem’s gift to make these changes and hope that Ofgem will seriously consider them.

| | Proposal for Ofgem | Rationale |
|----|---|---|
| 1 | Voluntarily subject its IAs to independent scrutiny by the Regulatory Policy Committee (RPC) ⁹ as a matter of course | We believe that the scrutiny of Ofgem’s Impact Assessments by an independent, expert third party will help ensure that their quality is of consistently high standard. |
| 2 | Adopt the Government’s template for Impact Assessments ¹⁰ | We believe that this would help ensure good quality regulatory decisions by promoting consistent good practice. |
| 3 | Always do a quantitative IA unless there is a very good and clearly stated reason not to | We believe that greater use of quantitative IAs will help ensure good quality regulatory decisions. |
| 4 | Establish the office of a Chief Economist that sits outside policymaking, monitoring and enforcement functions | A Chief Economist would be responsible for ensuring that quantitative Impact Assessments were done consistently to a high standard. Having a standalone office will help ensure a degree of internal challenge. |
| 5 | Create a dedicated Programme Management Unit (PMU) to manage complex industry change projects | This would help ensure that Ofgem has necessary project management skills to lead industry change programmes. |
| 6 | Always explain how it has taken consultation responses into account in its final decision | We believe that this will promote transparency and good quality regulatory decisions. Ofgem has not always said how it has taken representations into account in past consultations. For example Ofgem did not publish a response to its consultation on customer service indicators before it implemented some of its proposals. Ofgem also did not say how it took into account responses to its draft FWP for 2015-16. |
| 7 | Increase transparency in how proposed and final financial penalties are calculated | We believe that this will help ensure fair and consistent treatment of licensees under investigation. |
| 8 | State clearly where it makes trade-offs between statutory objectives duties and why it strikes that balance | This will enhance transparency and predictability in Ofgem’s decision-making. |
| 9 | Always consider how it will monitor the impact of its proposals early in the policy development phase | We believe that this will help Ofgem understand the impact of its interventions and change them if they are not working. |
| 10 | Always consider the merits of a sunset clause when proposing new | This could help embed the principle that continuing regulation needs to be well-justified |

⁹ <https://www.gov.uk/government/organisations/regulatory-policy-committee>

¹⁰ <https://www.gov.uk/government/publications/impact-assessment-template-for-government-policies>

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| | regulations | (as well as introducing regulation needs to be well-justified in the first place). |
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Minimising regulatory burdens

We are pleased that Ofgem is conscious of the need to minimise the cost that its activities impose on industry and consumers. Our response to Ofgem’s Simplification Plan describes the progress that we believe Ofgem has made in this area and suggests where there is room for further improvement. These can be summarised under the following headings:

- **UK Regulators Network (UKRN).** We believe that the UKRN can add more value by sharing consumer, economic and technical expertise rather than pressing for ‘nice to have’ cross-sector communications initiatives. The UKRN does not have the vires or institutional checks on its behaviour that sector regulators do. We therefore do not believe that the UKRN should make policy. If the UKRN does make change proposals then it should carry out a formal consultation and Impact Assessment like its members must.
- **Requests for Information (RFIs).** Ofgem should keep RFIs to the minimum required. Where RFIs are issued, Ofgem should (a) check whether other organisations with information request powers have made a similar request, (b) give advanced notice, (c) send a draft for comment, (d) stagger them sensibly and (e) provide as much time to respond as possible. Ofgem should hold a central record of the RFIs that it has sent out and provide to licensees a forward plan of the RFIs it is planning to send to them.
- **Industry change.** We know that the industry will have to make a number of very significant and complex changes over the next few years. These complex changes include smart meter rollout, Project Nexus, CoS Reform, the move to principles and any CMA remedies. Ofgem should not add to these complex changes unless there is a very good reason to do so; the threshold for intervention should be higher than ever.

Thank you again for the opportunity to comment on Ofgem’s plans for the coming year. We hope that Ofgem will explain how comments were taken into account when it publishes its final FWP, which we do not believe it has done before. In particular we hope that Ofgem will seriously consider our proposals.

We look forward to continuing to engage constructively with Ofgem across the board. If you have any questions about our response please contact Alun.Rees@britishgas.co.uk

Yours sincerely

Sharon Johnson

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