

## Memorandum by Centrica plc.

### Introduction

Centrica welcomes the opportunity to respond to the House of Lords Select Committee on Regulators inquiry into “UK Economic Regulators”.

Centrica plc was formed in 1997 when the former British Gas plc was demerged to form BG Group and Centrica. In Britain, it trades under its brand names, British Gas (Scottish Gas/Nwy Prydain) and British Gas Business. It is Britain’s largest energy supplier, supplying around 10 million gas and 6 million electricity customers in the domestic sector and around 1 million mainly Small and Medium Enterprises (SMEs) in the industrial and commercial sector. This response is on behalf of the Centrica group excluding Centrica Storage Ltd, (which operates separately from the rest of the Centrica group pursuant to the Undertakings given to the Secretary of State.)

Following the deregulation of the UK’s energy markets, Centrica operates in one of the most highly regulated markets. Unless stated explicitly, all the responses below relate to the Office of Gas and Electricity Markets (Ofgem).

**1. How do regulators interpret their statutory remit? Do they set themselves aims and objectives that take their work beyond fulfilling their statutory obligations? And, if so, why?**

1.1 Ofgem’s primary statutory duty is to protect consumers through the promotion of effective competition wherever appropriate and the effective regulation of the monopoly companies which run the gas pipes and electricity wires.

1.2 Centrica believes that in most cases Ofgem proactively interprets its statutory remit to its fullest extent. However, Ofgem can on occasion mistake the extent of its statutory obligation, as shown by the recent Public Accounts Select Committee’s report into Ofgem’s role in the Distribution Network Sales (DNS).

**2. Are regulators sufficiently independent from government to allow them full operational freedom of action? To what extent does the method by which they are funded have an impact on the measure of their independence?**

2.1 In comparison with Ofgem’s counterparts on the Continent, Ofgem has a high level of independence and operational freedom from government.

2.2 Ofgem is funded by those energy companies who are licensed to run the gas and electricity infrastructure. Being funded in this manner does not appear to place any constraint upon Ofgem’s independence and Centrica believes that there is sufficient transparency in how Ofgem plans and allocates resources.

**3. How can we assess whether regulators provide value for money?**

**a) Do their internal structures facilitate or hinder them in meeting their objectives with regard to providing value for money?**

Centrica believes that Ofgem is transparent in the planning and allocation of resources and costings. They have proved themselves to be relatively open to interested stakeholder comment and are also transparent in the recruitment and appointment of external consultants.

**b) Does the work of the National Audit Office help ensure that regulators provide value for money?**

The National Audit Office's role is to conduct financial audits of all government departments and agencies and many other public bodies and report to Parliament on the value for money with which these bodies have spent money. Ofgem is included in this remit.

Ofgem has indicated that they do not expect the majority of benefits from the Distribution Network Sales (DNS) to flow to consumers until after 2013. Centrica is therefore disappointed by the role of the NAO in the DNS in not ensuring more effective value for money for consumers as a result of the sale.

In addition, Centrica believes that the project based approach of the NAO is not helpful in ensuring that Ofgem provides value for money on a day to day basis.

**c) Have regulators sought to make appropriate efficiency savings through co-operation with other regulators, by selecting particular lines of inquiry and/or by other means?**

Centrica believes that Ofgem's self-imposed efficiency savings through the price cap budgeting system works effectively.

**4. Have individual regulators established effective collective working arrangements with both functional and sectoral regulators? Is the current Concurrency Working Party system providing sufficient opportunities for co-operation, communication and co-ordination between sectoral regulators and the Office of Fair Trading and Competition Commission?**

4.1 Centrica is not familiar with the operation of the Concurrency Working Party and accordingly cannot comment. In practice however, it is generally clear that Ofgem will handle competition investigations within the energy sector.

4.2 In relation to mergers, where the OFT (and the Competition Commission) has sole jurisdiction (as opposed to the sector regulators), the Concurrency Working Party has a clear role to play and this is an area where co-operation, communication and co-ordination is essential given the short timescales involved.

4.3 There is currently a split in regulatory duties between the DTI and Ofgem with regard to onshore and offshore regulation. Ofgem has the primary duty for onshore whereas powers to regulate the offshore industry fall to the DTI. Centrica recognises that Ofgem have at times found this onshore/offshore split challenging and recommends that further consideration is given to this issue.

**5. Have regulators created communications systems with their relevant industry or industries, which provide for accurate receipt and provision of information? Do regulators specify clearly and with adequate notice, what information they require from companies?**

5.1 Although the communication systems Ofgem has established with industry are generally good, Centrica still believes that there is room for improvement on overall levels of engagement with industry.

5.2 The timescale for responding to Ofgem consultations is on occasion too short. For example many of the DNS consultations gave only a four week window for responses and the Distribution Price Control consultations similar periods. Whilst Centrica appreciates that Ofgem has tried to improve in this area, we note that the statutory period for Government consultations is 12 weeks. Centrica believes that for major strategic or policy documents Ofgem should adopt this 12 week period and that a 4-6 week timescale for major responses should only be permitted in exceptional cases or where 28 days is laid down by legislation or regulation. As is currently the case with Ofcom consultations, Centrica believes that Ofgem should classify the nature of a given consultation up front and subsequently assign an appropriate timescale for responding accordingly.

5.3 On occasion, where Ofgem has requested information to be supplied, for example questionnaires issued to the industry as part of DNS, the timescales set are too short.

5.4 Centrica also recommends that, where appropriate, greater internal discipline is applied to Ofgem documents to avoid them becoming unduly and unnecessarily complex. Centrica does however recognise that this may not be achievable, e.g. in relation to documents relating to price controls. Ofgem has clearly been making efforts in this area, but the balance is not yet correct.

5.5 Centrica also believes that there is insufficient information published by the companies in relation to price controls and that more information should routinely be provided by companies relating to this matter and should be placed in the public domain.

**6 Are regulators sufficiently clear in presenting the reasoning and financial models that underpin their decisions? Are regulated companies given enough early warning before enforcement action to allow for self-correction?**

- 6.1 Ofgem is reasonably clear in presenting its reasoning. Following on from point 5.3 (above) Centrica believes that on occasion, Ofgem decision documents and consultations are over-long, and may therefore lack clarity. By contrast Ofcom consultation documents are much clearer in their communications with a more defined house style. Ofcom also produces consumer versions of appropriate documents and we would recommend Ofgem consider a similar approach. In addition it would be helpful if Ofgem documents were more mindful of their audience, for example by working in “money of the day” terms as well as real terms when presenting figures and prices projections. For example, the figures outlined in Ofgem’s 2005/2006 price controls document were presented in real terms with the exception of a table in the appendix. It would also be helpful if the actual cost to consumers was outlined more explicitly in appropriate documents.
- 6.2 Finally Ofgem impact assessments are often insufficiently robust and unclear see Q 17 below.
- 6.3 We would encourage Ofgem to continue its practice of seeking to allow for self-correction before pursuing formal enforcement – much can be achieved in the “shadow of coercion.” However we would ask Ofgem to reflect on the extraordinary costs that voluminous information requests can impose on a business.

**7. In summary how successful have the economic regulators been? What changes, if any, could improve their effectiveness?**

- 7.1 Ofgem is a leading regulator and has acquired a strong reputation amongst both the industry and its European counterparts in particular in relation to market opening and the design of competitive markets.
- 7.2 To improve the effectiveness of its economic regulation, we believe Ofgem should review its current network price control process. As matters stand, the price control process proceeds largely as a bilateral negotiation between the networks and Ofgem, with the people who pay the charges standing on the sidelines with comparatively little opportunity to engage effectively. This approach is no longer appropriate in a competitive market such as the UK energy market. We would encourage Ofgem to adopt an approach comparable with the process of “constructive engagement” adopted by the CAA in relation to the charges of BAA. Under that approach, key elements of the price control are left to negotiation between the regulated entity and the users of the regulated service, subject of course to review and approval by the regulator. This approach is more consistent with the principles of better regulation.
- 7.3 It would also be helpful if Ofgem could introduce clearer qualitative and quantitative reporting to show how they have best served consumers. This would improve both the effectiveness of and confidence in the regulator. For example the benefits to consumers of the recent DNS should have been more clearly shown, together with the method by which Ofgem intends to show that the expected benefits have been delivered.

**8. What is the appropriate definition of the “public interest” in respect of the activities of the economic regulators? Is there a divergence between consumer interests and wider societal concerns encompassed by the term “public interest”?**

8.1 Ofgem has generally been successful in balancing the interests of consumers and wider societal concerns for example such as the environment. However with the heightened of concerns about climate change, Ofgem faces very real challenges in the longer-term to maintain this balance.

**9. Have regulators been effective in protecting consumers from firms abusing their dominant positions in markets and restricting practices between firms that reduce competition? Have regulators successfully promoted the ability of consumers to switch firm at reasonable cost and without undue restrictions?**

9.1 Regulators have broad statutory powers and have demonstrated a willingness to investigate concerns on a formal and informal basis. Consumers are effectively protected.

9.2 In the early days of retail competition in the energy sector, Ofgem played a significant role in promoting switching. As the market and competition therein have developed, the commercial switching sites and energywatch have taken over in highlighting the ability and the benefits of switching to consumers.

**10. To what extent should the public interest influence regulators’ decisions on maintaining restrictions on competition? How should regulators ensure that regulatory restrictions on competition are limited and proportionate to the public interest they serve?**

10.1 Ofgem rightly believes that competition in a market acts as the main protection for consumers and seeks only to impose restrictions where necessary. It is clearly essential that such restrictions are not imposed before the market has had time to respond itself and are no greater than are absolutely necessary. In this latter respect, it is essential that full regulatory impact assessments of any proposed measures are carried out.

10.2 Centrica applauds the work undertaken by Ofgem in keeping the extent of regulation in the market under review, as shown by the current Supply Licence Review.

**11. What research have regulators commissioned into the public interest (s) they serve, amongst the industries they regulate and those industries’ customers? What use have they made of any such research?**

11.1 Ofgem has undertaken an appropriate level of research in specific areas, for example surrounding the quality of service standards. Where appropriate,

they have seemed willing to take on board any comments about such research.

**12. What scope do sectoral and functional regulators have to improve economic performance either within specific markets or the wider UK economy?**

12.1 Ofgem is rightly concerned to work for fair access and competitive markets within Europe in order to ensure that Britain can transport the gas needed in response to market signals. Ofgem has proven itself to be willing and able to respond to the challenge of the continued lack of liberalisation of continental energy markets and has assigned an appropriate level of resource to these challenges.

**13. Have regulators successfully facilitated the transition from public utility monopolies to effective competition within and between privatised or liberalised utilities? How has the restructuring of markets by regulators led to the development of better competition?**

13.1 Ofgem has facilitated the establishment of effective competition with the gas and electricity markets and we believe the market in this country has been working well for some time. Looking forward, it will be important that Ofgem continues a “light-touch” approach to regulation to ensure regulatory certainty and that regulation is sustainable and practical in relation to the business environment. The challenges of unliberalised continental markets remain however. Centrica believes that Ofgem must continue to focus on problems in this area as a priority, in order that the market in this country is not distorted by a lack of fair access and effective competition in continental markets.

13.2 Ofgem needs to recognise the energy markets are now mature, as evidenced by high levels of switching, significant innovation, and social policy initiatives that outstrip other competitive markets. Centrica believes that Ofgem needs to move away from an ‘incumbent supplier’ mentality, and embrace the fact that there are now many large and small suppliers operating in the market. Sometimes the right balance is not struck, and Ofgem can focus too much of its energy and resources on specific suppliers, rather than considering the market as a whole.

13.3 Ofgem has on occasion sought to pursue reforms which may have a theoretical appeal but which do not yield demonstrable benefits for the industry and consumer e.g. exit reform.

**14. Is there any evidence to suggest that regulatory activity affects industry investment levels? How can regulators improve market signals and incentivise longer-term investment in regulated markets? How should regulators improve and sustain business confidence in regulatory decisions?**

14.1 Regulatory activity is a key pivotal determinant in industry investment levels. Too much inappropriate regulation deters investment, whereas the right level

of regulatory activity can encourage investment. In order to incentivise longer-term investment, markets need robust regulatory certainty.

**15. By international standards, have UK regulators succeeded in promoting the international competitiveness of the UK economy? How do the UK's institutional and regulatory arrangements to promote competition compare with those of other countries?**

15.1 Ofgem has successfully promoted Great Britain as a model of an effectively functioning competitive market to its European counterparts. However, significant challenges remain in the development of regional markets, and the emergence of effectively functioning internal energy markets in Europe.

**16. Does foreign ownership of UK companies (particularly within utility markets) present specific and identifiable problems for the domestic regulatory framework?**

16.1 It is important to remember that there is already extensive foreign ownership of utility companies in the UK. Of the six main energy supply companies, 3 are owned by Continental companies and with the takeover of Scottish Power by the Spanish energy company Iberdrola, this will increase to 4. However this is not reciprocated on the Continent. To put matters starkly, there are 20 million domestic gas and electricity customer accounts supplied by French and German companies in the UK. However, there is not a single household - and precious few small businesses - in Germany or France that can choose a new supplier.

16.2 We welcome the recent conclusions of the European Commission's sector inquiry which identified serious problems in the EU's energy markets, including market concentration, vertical integration and possible collusion between incumbent operators to share markets. The findings also show that a failure to liberalise energy markets on the Continent does have a detrimental impact on consumers in this country.

16.3 Centrica therefore remains supportive of Ofgem's work in continuing to push the liberalisation agenda. The trend towards regional markets in electricity and gas in the EU poses a real challenge for Ofgem (and other regulators) going forward and there remains a question of how European regulators will interact in this framework. The growing interdependence of European energy markets means that European regulators (including Ofgem) will increasingly have to take into account the interests of EU citizens, not just national interests.

**17 To what extent have regulators established a Regulatory Impact Assessment process that:**

- **Is properly resourced and transparent**
- **Produces high quality consistent analysis**
- **Targets resources at areas of greatest economic risk**
- **Provides genuine consultation with stakeholders**
- **Requires regulators to explain why non-regulatory options have been pursued and:**

- **Is a policy-making tool rather than an explanatory tool (i.e. do regulators produce impact assessments as part of the development of policy and not just to justify it once established)?**

17.1 Centrica believes that Regulatory Impact Assessments should only be used for important regulatory changes although we recognise that there will be varying opinions on the definition of “important”.

In general, Ofgem’s Regulatory Impact Assessments tend to contain too much qualitative and not enough quantitative analysis. In addition, there is not enough information in the public domain on given issues, for example there is not enough underlying information provided regarding price controls and, in our opinion, the excuse of commercial confidentiality is often used by the regulated companies to ensure that this remains the case.

17.2 Regulatory Impact Assessments appear, on occasions, to have been used to produce support for Ofgem’s preference, rather than being part of the overall assessment of options.

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