

Corporate Response Form 'Ofgem Licence Modification Appeals' Consultation
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Additional comments

This non confidential response is on behalf of the Centrica Group of companies excluding Centrica Storage.

Centrica has taken an active part in the debate on the formulation of the third package and is supportive of the general aims of increased competition, transparency and harmonisation. We believe that the deregulated GB market is among the most investor friendly and competitive in the world and it is essential for the future of GB supply security in both gas and electricity that this important status continues.

The GB market is characterised by active competition with an excellent awareness of opportunities among consumers and a range of international investors. Given the Government Low Carbon targets and the consequent need for at least £200bn of investment, maintaining a healthy investment climate in which investors can operate confidently, facing reasonably predictable regulatory risk is essential.

In general, we believe that the totality of licence changes needed to bring GB in line with the 3rd package are relatively modest, and most of the necessary amendments relate to the transporter licences. While we understand that it may not be possible to retain a fully consensual regime in this case, we believe that DECC should restrict the changes proposed to those necessary to give effect to the 3rd package, and maintaining a reasonable balance of cost and risk.

In line with the principles of Better Regulation, we believe that the best approach is one that, where there is clear evidence that current arrangements have presented difficulties, is proportionate to the issue at hand. We believe that strong and active participation in the market by licensed entities is a positive thing, leading to improved investor confidence and high quality regulatory decision making. We do not believe that the current arrangements have led to general or undue delays in regulatory decision making or licence changes. This is evidenced by the co-operative approach taken to the Ofgem Supplier Probe and consequent licence changes.

Our primary concern as a licensee is with the regime applicable to supply, gas shipping and generation licences, the context here is very different to that of the networks, given that the regime is one of competition rather than natural monopoly. Given the modest amount of amendment required in these licences to implement the 3rd package, we do not see that the case has been made for the wholesale rejection of a consent based regime for these licences, though we do understand that the CLM thresholds may need to change to provide greater certainty around 3rd package implementation.

In this consultation, which proposes the removal of consent based processes in respect of change to the generality of Licences, DECC acknowledges that the proposals extend beyond the requirements to implement the legislation. Taken in conjunction with the process of significant code reviews (due to be introduced into the industry codes shortly), the change in the regulatory risk faced by participants is extensive and a significant concern to both participants and investors.

Centrica does not believe that these policy changes are necessary to give effect to the 3rd package, and while we are not opposed to change per se, in the interests of investor/industry confidence, we believe that changes should be limited to those necessary to achieve the desired results. As highlighted above, it is necessary to stress that the 3rd package provisions in this area are, in a large part, aimed at the ongoing regulation of monopoly networks.

DECC recognises in 2.5 that the regulatory framework should not discourage investment, but relates the point mainly to the regulation of the networks. We agree strongly with the principle, but we do not accept that the risk of discouraging investment would only eventuate if the special licence conditions (applicable to networks) were not afforded special treatment. Other parties (either licensed or potentially licensed) bring huge amounts of investment to the GB market, for example suppliers, low carbon generator developers and interconnectors as licensees and LNG/Storage operators as potential licensees.

The proposal is to completely remove licensees' ability to consent to licence changes on the basis that some licensees have the ability to block licence change, and that this ability is not equally available to all.

We do not believe that this proposal is necessary to either comply with the third package, or generate the competition benefits as set out in the IA. Indeed, we believe that a "consent based" approach (in which ex ante agreement between licensees is required ahead of regulatory change) encourages better quality regulatory decision making. That is not to say, however that we believe the current arrangements could not be made to be more effective. For example, we would be happy to support the recalibration of the current regime to achieve the required equalisation between parties, and believe that this could be achieved simply and efficiently at minimal cost and risk by adjusting the collective licence modification (CLM) thresholds.

Our preferred model for the competitive GB market therefore remains a consent based change process which we believe is the best option for all parties including consumers. On this basis, we do not support the proposed removal of the CLM.

The CLM process is well understood and we believe can be operated successfully to allow the implementation of changes expeditiously to meet the requirements for implementation of EU change. The minimum requirements for consultation are manageable and we see no reason why the provisions of the (amended) CLM should not be sufficient to meet the requirements.

DECC has identified in the IA a number of benefits from changes to the CLM arrangements, however we believe that the benefits can equally be achieved by threshold recalibration as suggested above, for example in the number of licensees objecting or the market share affected. While difficult to value, it is also important to recognise the high quality of engagement in the consultation process engendered by the current regime and the resulting benefits to regulatory decision making.

In terms of implementation of the 3rd package, a significant proportion of the additional powers to Ofgem relate to matters such as monitoring and information gathering, such matters are best addressed by adjusting Ofgem's (already extensive) information gathering powers, rather than removing the CLM.

Looking at the implementation of specific Agency decisions, the use of legislative powers to implement such change could provide a successful complementary mechanism. The use of such powers to effect limited change to licences is not without precedent in the industry, and has proved an efficient way forward. While we understand DECC's concern that this might lead to a more complex regime, we believe it would be generally straightforward to separate EU required change from GB elective policy change.

If the CLM is withdrawn from the competitive licences, which we do not support, we believe that the withdrawal should only apply for those matters resulting from EU legislation, rather than a general withdrawal which we do not believe to be justified.

In our view, in combination with an adjustment to the thresholds in the CLM to ensure equalisation, this would be a proportionate approach to the issue in a competitive market. Should this lighter touch approach prove, after a trial period, to be unworkable, we suggest that would be the point at which to implement the more extensive regime change proposed in the document of removing all participants' rights, subject to appeal.

However, if DECC remains committed to the approach of removing the consent based process at this stage, we believe that there are a number of essential safeguards which need to be put in place prior to removal. The two most important being:

- Ensuring that the default effect of an appeal is suspensory, allowing Ofgem to request a non suspensory appeal only where the licence change can be evidenced to be in the interests of security of supply.
- Appeals must be allowed based on merit, not purely process.

The current Code Modifications Appeals process has provided a good example of this approach and has not resulted in either large volumes of appeals or frivolous/vexatious appeals. Given there is already an effective process in place, it would be reasonable to extend this process into licence based appeals.

We would like to see DECC, Ofgem and the industry work together to effect the necessary adjustments. In our view the last Supply Licence Review provides a striking example of good practice and due process.

Consultation Questions

What should be the scope of the appeal mechanism?

1 Does the fundamental nature of price controls require they be subject to different treatment from other licence modifications? Please explain what changes you consider are required, why you consider they are required and how they would be compatible with the Third Package.

We are not convinced that special licence conditions do merit different treatment (in terms of consent) to other licence conditions in so far as risks to investor confidence arise more generally within the regime and not solely from changes to network licences.

However, we do agree with DECC that during any appeal process, the complex nature of these conditions may require additional scrutiny, and hence a potentially more lengthy process. We also believe that because of the impact these conditions have on other participants, then rights of appeal should also apply to defined third parties on the same basis as networks.

Clearly the appeal process will need to include protections in all cases against frivolous/vexatious appeals and as stated above, permit merit based as well as process based appeals. However, in our view the current Code Modifications Appel process provides a suitable mechanism. In practice, this process has demonstrated that the frivolous/vexatious appeals point does not appear to be a major concern.

Finally, we believe that as with other types of appeal, the presumption should be in favour of suspension of the change pending the appeal outcome. We believe the normal provision would be to continue to regulate based on the existing conditions in the case of an appeal. It may be in the limited case of price controls that there may need to be a provision to roll forward any parameterised values on a pro tem basis, where the existing control would otherwise fall, this might apply for example, to some of the incentive regimes.

What should be the structure of the appeal?	
2	Do you agree that a rehearing approach to appeals for modifications other than price controls strikes the right balance between appropriate economic scrutiny of the regulator's decisions and a timely appeals process that controls potential costs for the parties?
Yes, in general, however, we believe it would be wise to may provision for a full investigation either by application (in which case the appellant would need to justify) or by the decision of the Appellate body, if once the appeal has commenced it becomes clear that in that instance a full investigation would be appropriate.	
3	Do you agree there should be a full investigative hearing for price controls?
Yes, however, depending on where the balance of the obligation to provide information for the appeal rests, in the case of defined third party appeals, provisions may be required to ensure that the price controlled entity co-operates in the appeal to ensure that the ability to appeal is not frustrated due to the 3 rd parties' inability to secure the necessary information.	
Grounds for appeal	
4	Do you agree with our proposal for an appeal on the merits?
We agree that a merits based appeal should be available.	
5	Would our proposed grounds allow for consideration of legitimate legal, factual and economic issues, without undermining regulator independence? If not, please state why.
We agree that the proposed ground are sufficient and allow for full review. We believe that this is effectively illustrated by our practical experience gained during the Eon/Centrica UNC appeal in 2007.	
What who are the affected parties who should have right of appeal?	
6	Do you see any case for extending the right of appeal in relation to an Ofgem decision to any licensees or other materially affected parties beyond directly affected licensees? Please explain which and why.
Under the RIIO model, the right to appeal price control determinations has not been formally extended to third parties. However, engaged parties are now able to ask Ofgem to refer a price control determination to the Competition Commission if they believe a referral would be in the interests of consumers. We support this model, however, this does not imply similar approaches are appropriate for all areas of regulatory decision making.	
The appeal body	

7	Do you agree the CC is the most appropriate appeal body? Why/ why not?
We agree that the CC is the most appropriate appeal body, subject to the previous comments in this response on rehearing vs. full investigation.	
Outcome	
8	The Government would welcome views on whether the appeal body should have the power to vary Ofgem's decisions on matters, other than price controls, or whether such cases would be better handled by remitting decisions back to Ofgem to re-take, with any necessary binding recommendations.
<p>We agree that the appeal body should have the power to vary Ofgem's decisions, in addition to having the option to remit decisions back to Ofgem with binding recommendations.</p> <p>We believe it would also be appropriate to ensure some form of oversight re the appeal body decision, to ensure that all parties are satisfied the decision has been fully implemented where this is not achieved by direct intervention of the appeal body.</p>	
Time Limits for the process	
9	Do you think the Government's suggested timescales of 4 weeks to lodge an appeal, and a period of 4 months for the hearing of most appeals will ensure appropriate scrutiny and efficient decision making?
This seems reasonable, but we suggest consideration be given to a provision for extension in exceptional circumstances.	
10	Do you see any circumstances in which an appeal may need to be subject to a faster timeline. If so can you provide examples?
<p>Our own experience of the Code Modifications Appeals process demonstrates that appeals can be dealt with both effectively and expeditiously, while still providing a full exploration of the facts of the case. In general therefore we would not expect faster timelines to be required.</p> <p>The only areas in which this appears likely are those where the implementation of the licence change is time limited for some specific reason or where the change relates to security of supply issues. Given that it is essential proper attention is given to appeal matters, we believe that faster timelines should only be used in exceptional circumstances and by application to the appeal body, with proper justification. To provide additional rigour, the rules that define whether (or not) an issue can be subject to "fast tracking" should be clearly defined and subject to consultation.</p> <p>Where such shortened timescales are used, there should be an automatic presumption of a post implementation review to be completed within [6] months of the implementation.</p>	

Can Ofgem's decisions be suspended?	
11	Do you agree the appeal body should be given the discretion to suspend Ofgem's decisions on application if they could lead to significant and potentially unnecessary expense and/or disclosure of confidential information?
<p>We believe that the presumption should be in favour of suspension unless Ofgem or the appellant requests otherwise, for example on the basis of supply security or some other urgent, time limited event.</p> <p>The normal presumption in terms of disputed changes would be maintenance of the status quo pending resolution of the dispute, and we can see no reason why this normal practice should be set aside as a matter of default.</p>	
How will the costs be recovered?	
12	What will be the likely costs and benefits of these changes on your organisation?
Specific examples not available	
13	How do you recommend potential costs could be reduced? How could we maximise the potential benefits to the regulatory regime as a whole?
<p>We believe that costs could be reduced by implementation of the minimum necessary change to achieve the desired results (as put forward above), followed by evaluation. For example, recalibration rather than removal of the CLM and the use of powers for EU specific change, could be simply achieved with, we believe, minimal costs.</p> <p>Only if these simple changes are shown to be ineffective should more extensive change (with associated costs) be considered.</p>	

Impact Assessment Questions	
<p>These are partial Impact Assessments containing our initial qualitative assessment of the costs and benefits. We therefore would welcome any quantitative evidence to support the further development of these impact assessments. Any information provided will be treated with sensitivity and anonymity.</p>	
14	Are the assumptions made in the Impact Assessment correct and have we correctly identified the costs and benefits associated with this measure? The Government would welcome any information that could improve our analysis of the costs and benefits highlighted in the Impact Assessment.
<p>We do not support the proposed approach, as we do not believe that the extensive changes are required or justified in order to implement the 3rd package.</p>	

We believe that the anticipated benefits are generally achievable based on a simpler suite of changes. The extent of change deriving explicitly from EU legislation does not, in our view, justify reformulating the entire GB licensing regime around the EU changes.

While we understand that this may require a degree of separation in Ofgem's approach, we do not believe the EU changes will be so extensive that this is not manageable.

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| 15 | What would be the likely costs and benefits of the 'minimum implementation option' of having two parallel separate regimes; one for those relating to regulatory tasks and Third Package duties, and one for Ofgem's domestic tasks? How would these compare to the costs and benefits of the proposed implementation option? |
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Additional Comments

