

## Code Governance Review – Final Proposals

**Document Type:** Decision Document

**Ref:** 43/10

**Date of Publication:** 31 March 2010

**Target Audience:** Gas and electricity industry participants, consumer representatives, code administrators, Competition Commission and other interested parties.

### Overview:

The industry codes are the contractual arrangements that underpin the electricity and gas wholesale and retail markets and which define aspects of the terms under which industry participants can access the electricity and gas networks. In November 2007, we launched a review of the arrangements for governing these industry codes to ensure that they were still fit for purpose given the wide range of changes that had occurred since the introduction of the codes and also given the scale of challenge the industry faces over the coming decade.

This document sets out our Final Proposals for the Code Governance Review (CGR). It incorporates and pulls together initiatives previously consulted upon under various CGR work strands. Our Final Proposals include a wide range of changes to the industry codes, and seek to make existing governance processes more transparent and accessible, which is particularly important for small participants and consumer groups. The Final Proposals include:

- defining a role for Ofgem to lead significant changes to the industry codes;
- allowing Ofgem to step back from those parts of the code arrangements that have minimal impact on consumers; and,
- incorporating network charging methodologies into relevant industry codes, giving users the opportunity to propose change.

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## Context

The Authority is committed to policies and processes that are consistent with better regulation principles and that reduce administrative burdens on business while maintaining effective consumer protection.

As part of that commitment, in November 2007, we announced the Review of Industry Code Governance. We considered that such a review was timely given the changes that have occurred in the market, where the nature of participation is evolving, particularly for new entrants and smaller players. The Authority's role in relation to code modifications has also changed with the introduction of additional statutory duties and the right of appeal to the Competition Commission.

In summer 2009, we consulted separately on our initial proposals for each of the Code Governance Review work strands. This document pulls together the different CGR work strands and sets out our Final Proposals for the Code Governance Review package.

We have also published today our consultation on the form of the modifications required to a number of network companies' licences to bring effect to the Final Proposals. Further statutory consultations on licence changes will be required following this consultation.

A wide range of industry code modifications will be necessary to bring effect to the Final Proposals. We expect these to be raised this spring/summer with full effect to be given to these proposals by autumn 2010.

## Associated Documents

- [Open letter announcing review of industry code governance - Ofgem Ref: 284/07](#)
- [Corporate Strategy and Plan 2008-2013 - Ofgem Ref: 34/08](#)
- [Review of industry code governance - scope of review - Ofgem Ref: 92/08](#)
- [Code Governance Review: Charging methodology governance options - Ofgem Ref: 132/08](#)
- [Review of Industry Code Governance – Environment and Code Objectives, Ofgem open letter, 21 November 2008](#)
- [Review of Industry Code Governance – role of code administrators and small participant/consumer initiatives - Ofgem Ref: 173/08](#)

- [Review of Industry Code Governance – Code Administrators’ Working Group - Ofgem open letter, 20 April 2009](#)
- [Review of Industry Code Governance - Environment and Code Objectives - Ofgem Ref: 66/09](#)
- [Code Governance Review – role of code administrators and small participant/consumer initiatives – initial proposals - Ofgem Ref: 85/09](#)
- [Code Governance Review: Major Policy Reviews and Self-Governance - Initial Proposals - Ofgem Ref: 84/09](#)
- [Code Governance Review: Governance of charging methodologies: Initial proposals - Ofgem Ref: 108/09](#)
- [Codes Governance Review Initial Proposals - illustrative licence modification drafting - Ofgem Ref: 133/09](#)

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## Summary

Many of the rules and commercial and technical obligations that govern participation in Great Britain's gas and electricity sectors are set out in multilateral codes. These codes significantly impact on the shape and development of the gas and electricity sectors and, by extension, on our ability to deliver markets that best protect the consumer interest while addressing the need to secure energy supply and contribute to the achievement of sustainable development.

In November 2007, we announced the Review of Industry Code Governance. This document sets out Final Proposals from this review. These Final Proposals are the culmination of two years' work and have been developed in consultation with industry through a number of separate work strands.

The Review has identified a number of deficiencies in the existing code arrangements which this package of proposals seeks to remedy. There are a wide range of proposals set out in this document and a table summarising these proposals is provided below. At a high level, we consider the proposals fall into two main areas. First, the proposals seek to reduce unnecessary barriers and red tape in the existing industry codes governance arrangements. Where possible we have sought to simplify existing change processes, making them more consistent between industry codes, more transparent and more accessible. For instance there will be more common, user-friendly and accessible templates for raising modifications across the codes. We are also requiring Code Administrators to take a more active 'critical friend' role, particularly in providing assistance to smaller parties and consumer representatives who may otherwise be restricted in their ability to fully participate in the process. This package of reform is valuable to all market participants but particularly so for small parties or new entrants and also consumer groups.

Second, whilst we recognise that the existing code governance arrangements have worked well in providing incremental change to industry codes, they have not been effective in supporting larger scale and more complex change. From the case studies that we have undertaken we consider that these inefficiencies have led to significant potential consumer detriment, perhaps of the order of £100m. Given the need for the industry to rise to the challenge of the Government's social and environmental energy goals and given the possibility of change which is required as a result of European legislation, we consider it critical that significant code changes can be facilitated more quickly and effectively. As part of these Final Proposals we are defining a role for Ofgem to lead Significant Code Reviews (SCRs) to address these issues. Our Final Proposals will also provide for us to step away from code modifications that have minimal customer impact and provide a much greater role for the industry to govern itself in such areas. We consider that this will deliver significant efficiencies.

We propose to open up the network companies' charging methodologies by giving network users and other materially affected parties the right to raise proposals to modify those methodologies. We will do this by inserting charging methodologies into the relevant industry codes and utilising the existing (soon to be improved) code modifications procedures. Finally, we propose to clarify the requirement to assess

the environmental impacts when considering code proposals in accordance with Ofgem guidance.

## **Way Forward**

In addition to our Final Proposals, we have today published a minded-to consultation on the Code of Practice that the industry has developed for code administration through the Code Administrators Working Group. The Code of Practice sets out best practice in code administration and provides the basis for a number of the proposals in this document. Subject to this final consultation, we expect industry participants and Code Administrators to adhere to the high level principles set out in the Code of Practice.

We have also published today our consultation on the form of the modifications required to a number of network companies' licences to bring effect to the Final Proposals and will be holding a workshop 23 April 2010 to discuss these changes further. We then expect to issue a series of statutory consultations on licence changes in late May 2010.

## Overview of our Final Proposals

<b>Work strand Key Changes</b>	<b>Summary</b>	<b>Codes Affected</b>
<b>Significant Code Review ('SCR')</b> <ul style="list-style-type: none"> <li>▪ Significant Code Review (previously 'Major Policy Review')</li> </ul>	<ul style="list-style-type: none"> <li>▪ New role for Ofgem to lead SCRs</li> <li>▪ Licensees to raise modifications (where appropriate) following a SCR.</li> <li>▪ Unless Ofgem approves otherwise, non-urgent modifications on related matters will be incorporated within the SCR.</li> <li>▪ Alternatives to SCR modification proposals can be raised during the working group stage.</li> </ul>	UNC, CUSC, BSC
<b>Self-Governance ('SG')</b> <ul style="list-style-type: none"> <li>▪ New process for non-material changes</li> </ul>	<ul style="list-style-type: none"> <li>▪ New modifications path where proposal is likely to have non-material impacts.</li> <li>▪ Panel determines if proposal suitable for SG.</li> <li>▪ Ofgem power to override Panel filter decision.</li> <li>▪ Industry to develop voting arrangements.</li> <li>▪ Equal rights for all parties to appeal self-governance modifications decisions to Ofgem.</li> </ul>	UNC, CUSC, BSC
<b>Role of Code Administrators ('CA')</b> <ul style="list-style-type: none"> <li>▪ 'Send back' powers</li> <li>▪ Obligation to assist parties</li> <li>▪ Code of Practice</li> <li>▪ KPI</li> <li>▪ Voting consumer rep</li> <li>▪ Independent Panel Chair</li> </ul>	<ul style="list-style-type: none"> <li>▪ Ability to 'send back' final modification report to Panel if Authority considers it is deficient.</li> <li>▪ 'Critical Friend' obligation on CAs to assist where requested.</li> <li>▪ Code of Practice standard process and templates for key stages in modifications.</li> <li>▪ Adoption of and reporting on KPIs by CAs to be catered for in the Code of Practice.</li> <li>▪ Consumer rep on UNC Panel able to vote.</li> <li>▪ Requirement for independent Panel Chair appointed by licensee(s) subject to approval by Authority.</li> <li>▪ Panels to provide reasons for their recommendations and decisions.</li> </ul>	UNC, CUSC, BSC
<b>Charging Methodologies</b> <ul style="list-style-type: none"> <li>▪ Transfer of charging methodologies into relevant industry codes (Open Governance)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Inclusion of specific charging methodologies in industry codes - allows materially affected parties to propose changes.</li> <li>▪ Proposal window to facilitate effective management of modification process.</li> <li>▪ Authority ability to designate a non-code party as a materially affected party.</li> <li>▪ 25 day KPI for decisions (longer if doing IA).</li> <li>▪ Requirement to maintain charging forums.</li> </ul>	UNC (distribution limited to Use of System charges only), CUSC
<b>Environment / Objectives</b> <ul style="list-style-type: none"> <li>▪ Panels to have regard to greenhouse gas emissions</li> </ul>	<ul style="list-style-type: none"> <li>▪ Panels to assess (where applicable) economic impact of greenhouse gas emissions when considering modification proposals.</li> </ul>	BSC, CUSC, UNC, IGT UNC, DCUSA, STC, Grid Code, Dist. Code



## 1. Introduction

### Purpose and structure of this document

1.1. The nature of the regulatory issues facing industry participants, Government and Ofgem is becoming more challenging in the face of climate change and, from a security of supply perspective, Great Britain's increasing dependence on external energy sources. We consider that the code arrangements have been severely tested in key areas that are significantly impacted by public policy issues such as sustainable development and security of supply.

1.2. Given the evolving nature of the market as well as developments in the Government's energy and sustainability policies, it is very likely that further strategic issues will arise over the coming years which have significant impacts on the codes arrangements.

1.3. The purpose of this document is to set out our Final Proposals for reform of the code governance arrangements. The various proposals set out in this document are designed to address our fundamental objective which is to develop an overall set of code governance arrangements that lead to more effective and efficient decision-making.

1.4. The code governance review has taken forward a number of different work strands and the document is structured as follows:

- **Chapter 2** sets out our Final Proposals for **Significant Code Reviews** (previously Major Policy Reviews) and **Self-Governance** work strands and how these have developed following responses to initial proposals. Further details are provided in appendices 2 and 3;
- **Chapter 3** sets out our Final Proposals for the **Role of Code Administrators** and the changes we have made from our initial proposals;
- **Chapter 4** summarises the views of respondents to the **Governance of Charging Methodologies** initial proposals and sets out our Final Proposals;
- **Chapter 5** summarises the views of respondents to the **Environment and Code Objectives** and sets out our Final Proposals;
- **Chapter 6** sets our final views on the issue of code modifications "**timing out**";
- **Chapter 7** outlines our **next steps**.

1.5. In our separate Appendix document containing appendices 8-10 we set out Final Impact Assessments for Significant Code Reviews and Self Governance, Role of Code Administrators and Governance of Charging Methodologies. We did not carry out an Impact Assessment for the Environment and Code Objectives work strand as we did not consider this to be a significant change to code parties, given that they already

had the ability, if not express requirement, to take account of the environmental impact of proposed code changes.

## Background

1.6. In November 2007, we initiated our Review of Industry Code Governance with an open consultation. We commenced the Review because:

- the major codes had been introduced some time ago and since their introduction there have been significant changes in the market and regulatory landscape, which raised the possibility that the governance arrangements may no longer be optimal;
- the Authority's statutory duties have changed, for example with the inclusion of duties relating to sustainability, the environment<sup>1</sup>, and better regulation<sup>2</sup>;
- certain decisions of the Authority in relation to code modifications are now subject to appeal to the Competition Commission;
- the Authority is now required to undertake impact assessments before reaching certain important decisions, including in relation to some code modifications<sup>3</sup>;
- the nature of the market place has evolved, in particular with the entry of smaller players including renewable and distributed generators; and
- concerns had been expressed by small market participants that the existing code arrangements were too complex and inaccessible, particularly for the smaller new entrants, and that weaknesses in the governance regime prevented industry and consumers getting full value from the code arrangements.

1.7. At this time we also set out a number of core and broad objectives that we considered should frame the Code Governance Review. We considered a governance regime should:

- promote inclusive, accessible and effective consultation;
- be governed by rules and processes that are transparent and easily understood;
- be administered in an independent and objective fashion;
- provide rigorous and high quality analysis of the case for and against proposed changes;
- be cost effective;
- contain rules and processes that are sufficiently flexible to circumstances that they will always allow for efficient change management; and
- be delivered in a manner that results in a proportionate regulatory burden.

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1 Energy Act 2008.

2 Energy Act 2004.

3 Section 5A of the Utilities Act 2000 as amended by the Sustainable Energy Act 2003.

1.8. In June 2008 the Authority published its decision on the scope of a review of Industry code governance ('the June document')<sup>4</sup>. The June document set out the programme of work for the Code Governance Review, which it defined as encompassing six work-strands:

#### Delivery of major policy reform and self governance

- We undertook to consult on a framework under which Ofgem would manage major policy changes by initiating and leading high level code reviews, the conclusions of which would be legally binding, for example, upon relevant code panels/industry participants to implement through modification proposals. In parallel we undertook to consult on proposals to enable Ofgem to step out of the codes decision making process on proposals that have low customer impacts.

#### Role of Code Administrators

- We undertook to consult on a range of options intended to improve the quality of analysis undertaken by code panels and administrators on code modifications.

#### Initiatives to support smaller players

- We undertook to explore, as part of our work on the role of code administrators, whether there are requirements we can place on code panels and administrators to consider the needs of smaller suppliers and generators.

#### Addressing complexity and fragmentation

- We undertook to convene a working group of code administrators to explore simplification and convergence of code modification processes and encourage best practice.

#### Charging methodologies

- We undertook to consult on a range of options that could make the charging methodology change process more accessible to market participants.

#### Code objectives

- We undertook to consult on amending the industry's decision criteria on code modifications to take into account environmental impacts.

1.9. Initiatives to assist smaller participants did not form a discrete work strand, but formed an objective for the work undertaken elsewhere, in particular when considering the role of the Code Administrators.

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<sup>4</sup> See Ofgem's "Review of industry code governance – scope of the review", Decision document, June 2008.

1.10. The work to address the complexity and fragmentation of the code modification procedures was taken forward under the auspices of the Code Administrators' Working Group (CAWG). The objectives of the CAWG were to explore, identify and progress opportunities for:

- making the code modification process more accessible, usable and transparent for all parties including consumers, new entrants and smaller market participants; and
- encouraging best practice and, where appropriate, the simplification and convergence of code modification processes.

## **EU Third Package**

1.11. This paper is the culmination of around two years of industry effort to address existing problems with its own governance arrangements, which are having a clear and present impact on the industry's ability to respond to key challenges which have been discussed at length during the course of this review.

1.12. Since the commencement of the Review, a 'Third Package' of legislative measures towards the creation of a single EU energy market has entered into force. The aim of the Third Package is to deliver choice for consumers and more cross-border trade so as to achieve efficiency gains, competitive prices and higher standards of service, and to contribute to security of supply and sustainability. One of the recommendations of the Third Package is that national energy regulators should become more effective and have stronger, better defined powers to take appropriate measures where electricity and gas markets are not functioning properly.

1.13. Our current view is that the Significant Code Reviews (SCRs) are within the spirit of, and consistent, with the Third Package. However, the implementation of the EU Third Package may require some changes to industry governance arrangements beyond those set out in this paper. We consider that it may be several months before we can form a firm view on the impact of the Third Package, in particular following consideration of any Government proposals to transpose the Third Package into UK legislation. We will consult on any changes to the governance arrangements that are required in the light of the EU Third Package in due course.

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## 2. Significant Code Reviews and self-governance

This chapter summarises respondents' views to our initial proposals and sets out our Final Proposals for Significant Code Reviews (SCRs), which we have referred to in earlier documents as Major Policy Reviews, and self-governance. We have set our detailed proposals for the SCR and self-governance processes at appendices 2 and 3.

2.1. It is critical that significant code changes can be facilitated more quickly and effectively, given the need for the industry to rise to the challenge of the Government's social and environmental energy goals and given the possibility of change which is required as a result of European legislation. By redefining a role for Ofgem within the code arrangements to progress significant code reforms and require their implementation by industry, many of the inefficiencies and delays associated with the existing processes can be avoided. These inefficiencies and delays potentially hamper important implementation of code reforms and can have direct negative impacts on, for example, competition, new entrants and ultimately customers.

2.2. We have noted respondents' concerns that our proposals implied a potential blurring of responsibilities between the Government and the regulator. It is not our intention for the SCR powers to be used in areas properly reserved for Government. Our aim is to facilitate consideration of decisions on complex reforms of a technical nature, in a way that is consistent with Government and European policy.

2.3. In the past we referred to our thinking in this area as 'MPRs'. We recognise that this language might have led to confusion about our intentions. We have therefore chosen to replace the term 'Major Policy Review' with 'Significant Code Review'. We consider that this will minimise confusion going forward. For convenience we will henceforth in this document refer to Significant Code Reviews (SCRs) even where referring to our initial proposals of July 2009.

2.4. Our Final Proposals will also provide for us to step away from code modifications that have limited impacts. We propose to introduce self-governance where, in the view of the relevant code panel, a modification proposal would be unlikely to have material impacts on, for example, consumers, competition or sustainable development, will deliver significant efficiencies to the code governance arrangements.

### Code deficiencies

2.5. We consider that one of the key deficiencies of the existing code arrangements is their failure to deliver reforms in key strategic areas (of which electricity cash-out and transmission access are recent examples). The existing arrangements are capable of addressing discrete changes which only impact on the industry rules to a limited extent. However, the arrangements are not suited to addressing significant changes, especially if these touch on a number of separate industry governance documents.

2.6. Experience suggests that in the absence of this reform the industry code governance process could frustrate delivery of Government policy and European legislation. We expect that the SCR process will lead to more efficient reform of the industry codes and ensure that customers obtain the benefits which flow from significant code modifications at an early stage.

2.7. We consider that these potential benefits are material. In our December 2008 consultation document we included a case study on the benefits of the proposal which focussed on the reform of the electricity cash-out regime. We estimated that, had Ofgem been able to initiate a SCR at an early stage in the consideration of the cash-out regime, reform of the regime may have been achieved at an earlier date which would have resulted in "earlier" benefits to consumers in the range of £100m. Earlier delivery of effective electricity transmission access reforms may also have contributed to the more timely management of constraints costs which might have saved customers costs in the range of hundreds of millions of pounds.

2.8. In our initial proposals we set out our concerns that the existing code governance arrangements had been severely tested in the case of key strategic reforms. We cited difficulties and delays caused by the need to give effect to major reforms by raising multiple code modification proposals. We also highlighted the inefficiency of duplicate assessment processes and the piecemeal development of proposals. We noted that while diversity of viewpoints was welcome, consensus on the need for and nature of reforms should not be a pre-requisite for making them.

#### Responses to initial proposals

2.9. Responses to our initial proposals were mixed. Some respondents broadly accepted our position but others argued that the codes arrangements generally worked well. Several parties noted our examples of where industry procedures had frustrated necessary reforms, but contended that the problem was not so much a fundamental problem with the codes arrangements themselves, but that Ofgem and the industry did not agree on what reforms were necessary.

2.10. Some respondents argued that some of the weaknesses of the current regime were in fact strengths, i.e. the ability for industry to raise multiple proposals ensured consideration of the widest possible number of alternatives, while piecemeal development enabled industry and Ofgem to react to new information. These respondents requested Ofgem think very carefully about the extent of the deficiencies before seeking radical reforms to governance.

#### Ofgem's Final Proposal

2.11. Ofgem continues to hold the view that the present industry code governance arrangements are not likely to be conducive to implementing the significant code reforms that may be necessary in order, for example, to maintain secure supplies and deliver a low carbon energy sector.

## **Significant code reviews and self-governance: a proportionate and efficient package**

2.12. In our initial proposals we sought views on whether our proposals for SCRs and self-governance were a proportionate response to the deficiencies that we had identified.

### Responses to initial proposals

2.13. About a third of respondents agreed that our proposals for SCRs were likely to be proportionate, although some noted that more detail was needed to form a view. It was noted that Ofgem must retain an open mind during the process. One respondent, whilst opposed to our proposals, stated that the process had to be multilateral and not simply a dialogue between Ofgem and network operator(s).

2.14. The self-governance proposals enjoyed wide support among respondents, although several felt we had significantly overstated the proportion of modifications that would follow this route given our July 2009 proposal that only modifications that were likely to have trivial impacts should proceed to self-governance.

2.15. By contrast, many respondents stated that our SCR proposals were disproportionate. Some of those respondents felt that it would be better for Ofgem to engage more closely with the existing codes governance process, as an "active facilitator". Several argued that SCRs would increase uncertainty and costs for companies, which they considered was especially undesirable given the need for major investment in energy infrastructure over the next few years.

2.16. Some did not support Ofgem taking powers to direct industry parties to raise code modifications given that the Authority will be ultimately deciding whether or not to approve such modifications. Those respondents stated that the SCR proposals raised doubts about our impartiality. Some respondents believed the appeal rights should be strengthened either by allowing appeals of all SCR-related code modification decisions or by introducing a collective licence modification-style blocking minority. Some doubted the legality of our SCR proposals in the absence of primary legislation and called for the Government to give our proposals legitimacy through legislation. There was also a concern that if Ofgem took these powers it would be able to stray into areas of policy making that were properly for Government rather than the regulator.

### Ofgem's Final Proposal

2.17. We do not agree with the comments raised by respondents concerning the potential need for additional legislation to give effect to our proposals. Our Final Proposals fit within the existing statutory framework governing our principal objective, general duties and functions and the licensing regime (which, in turn, provides the basis for the industry codes to which the proposal relates). However, we have made a number of adjustments to the proposal in order to address some of

the concerns voiced regarding our role in relation to code governance and to emphasise our strong commitment to procedural fairness and the principles of better regulation.

2.18. As noted above, we did not intend that the SCR power would be used in areas properly reserved for Government. Through our normal dialogue with Government we are likely to discuss potential issues that might warrant consideration as an SCR and identify whether there are any areas of inconsistency with the Government's policy framework. In any case, we propose to consult on whether we should initiate a SCR as set out below and therefore we consider that through these processes we will not stray into policy areas reserved for Government. The aim of the SCR is to facilitate complex, technical reforms that would be consistent with Government policy and the delivery of policies agreed at European or UK level.

## **Efficacy**

2.19. We also sought views on whether, for key strategic areas, our proposals would enable a more holistic and efficient appraisal of the case for reform on key strategic areas. We also proposed to introduce SCRs and self-governance as a package of governance reform.

### Responses to initial proposals

2.20. Many parties acknowledged that it would be desirable to create a holistic governance process and noted that some Ofgem leadership was needed. Most of those who commented believed that the SCR proposals could achieve this. Others disagreed or at least felt unable to answer without further information especially on the process and timescales for SCRs. It was argued by some that the SCR proposals were inefficient because there would necessarily be duplication of analysis (carried out during the Ofgem-led part of the SCR process and then subsequently after the modification proposals had been raised). It was also argued that if no new analysis was carried out on the actual code modification proposal itself, any subsequent code modification decisions would potentially be based on out of date analysis.

2.21. There was also concern that the debate could be forced prematurely into a particular solution favoured by Ofgem, leading to sub-optimal outcomes and/or the risk of more appeals. The respondents who commented did not believe that the two elements of the proposals (namely, the combination of SCRs and self-governance) needed to be treated as an indivisible package. Many stated that as self-governance was so evidently beneficial, Ofgem should implement it regardless of the outcome of the debate on SCRs.

### Ofgem's Final Proposal

2.22. We do not consider that it is disproportionate to seek a greater role in leading the future development of the industry codes. We continue to believe that if Ofgem manages an inclusive, holistic review process potentially leading to a direction that



code modifications be drafted, there is scope to deliver significant code changes more efficiently and effectively than under the existing arrangements. In the light of comments, we have sought to refine our SCR proposals in certain important respects and to provide more clarity on the procedures that we envisage would be followed. We describe these refinements later in this document. We also intend to introduce self-governance across the main industry codes as part of a package of governance reform.

## **Applying the package to all or some of the codes**

2.23. We sought views on whether we should apply the package to all of the codes, and whether simultaneously or in a phased manner.

### Responses to initial proposals

2.24. We presented two options in our Initial Proposals: to prioritise the BSC, CUSC and UNC, excluding the other codes; or to apply the package to all of the other codes simultaneously. Views were fairly evenly divided between the two options. Consumer Focus said the entire package should apply to all codes. National Grid said that SCRs should apply to all codes as each might be affected by an SCR.

### Ofgem's Final Proposal

2.25. We propose to prioritise the introduction of the SCR and self-governance package to the BSC, CUSC and UNC at this stage. We consider that any future major policy reform is likely to be capable of implementation through changes to these codes.

2.26. We cannot rule out SCRs impacting on other codes, though we consider the risk to be more limited. We note, for example that, in relation to smart metering, Government may be better placed to act given the powers afforded to the Secretary of State through the Energy Act 2008. This could involve changes to licences and associated documents such as industry codes for the purpose of facilitating the timely and efficient roll out of smart meters.

2.27. Applying SCR powers to only the BSC, CUSC and UNC would not preclude us from extending the new arrangements to the other codes in the future. In the meantime, we have paid particular attention to the potential overlap between the BSC, CUSC and UNC and other codes.

## **Determining the code modification pathway**

2.28. In our initial proposals, we proposed the creation of three potential paths for modification proposals as compared to the current single modification path. The paths were:

- Path 1 - Significant Code Review;
- Path 2 - reformed status quo; and
- Path 3 - self-governance.

2.29. We proposed that Ofgem should have the ability to start a SCR where a modification proposal is likely to have significant impacts on consumers, competition or other issues relevant to our statutory duties such as sustainable development. We also set out that criteria would be needed when a modification is raised so that code panels could assess whether a modification proposal should follow Path 2 or 3. Our initial proposals also proposed that code panels should direct modifications either to Path 2 for Ofgem decision (where they are likely to have non-trivial impacts) or to Path 3 for the self-governance process (where the impacts are likely to be trivial).

### **Filtering criteria**

#### Path 1 – Significant Code Review

2.30. We proposed that we should have the ability to initiate an SCR where a modification proposal is likely to:

- have significant impacts on gas and electricity consumers or competition; and /or
- have significant impacts on the environment, sustainable development or security of supply; and /or
- create significant cross-code or code-licence issues.

2.31. We proposed that that we should also have the ability to initiate an SCR in response to Government policy decisions or unforeseen circumstances that appeared to Ofgem to require us to consider the case for significant code reform. Ofgem would decide whether these criteria were met rather than relying on code panel recommendations.

#### Path 2 – Improved status quo

2.32. In our initial proposals, we proposed that a code panel should be required to direct a modification proposal to the Path 2 process if, in its opinion, the proposal was likely to:

- have non-trivial impacts (on consumers; competition; sustainable development; the operation of the relevant gas or electricity system);
- discriminate in its effects between classes of users; and/or
- relate directly to safety or security of supply or relate to the management of market or network emergencies.

2.33. We also proposed that, where modification proposals were likely to have a non-trivial impact on the code change process or on other proposed material code governance changes, those modifications should follow Path 2 rather than self-governance. We noted that in all such cases the Authority would make the final decision on whether to approve the modification proposal.

### Path 3 – Self-governance

2.34. Our initial proposals also proposed that a code panel should direct a code modification proposal into the self-governance route if, in its opinion, the modification proposal would be unlikely to have non-trivial impacts on the matters set out above.

### Responses to initial proposals

2.35. Most respondents agreed that the criteria set out in our initial proposals were broadly sensible. Some believed that detailed guidance would be necessary. Those who did not consider that further guidance was necessary believed it was preferable to retain flexibility and adopt a pragmatic approach. All respondents who commented agreed that there was a need to retain a code modification development path that led to decisions ultimately being taken by Ofgem.

### Ofgem's Final Proposal

2.36. We propose that all modification proposals should follow one of the three development paths set out above. This includes retaining an improved version of the status quo in which certain code modification decisions are made by Ofgem (our proposed improvements are set out elsewhere in this document).

2.37. Further detail of the SCR process is set out in the Annex 2 to this document.

## **Industry codes self-governance**

2.38. We consider that introducing self-governance arrangements into the industry codes will ensure that our resources are focussed on those issues that are more material to consumers or our other statutory duties with consequential better regulation benefits. A large number of modification decisions could be addressed by self-governance with the potential to reduce costs and facilitate faster implementation of change proposals.

2.39. There was widespread support for greater self-governance. However, some respondents suggested that few modifications would meet the requirement of having a 'trivial effect' as we put forward in our initial proposals. Several suggested that self-governance proposals should not be contingent upon SCRs being introduced.

2.40. We consider that there is merit in the self-governance process even if the number of self-governance modifications proves to be lower than anticipated in our impact assessment. We have however reconsidered the filtering criteria that we set out in our initial proposals. We now propose that modifications that are likely to have non-material impacts should proceed through self-governance processes.

2.41. Several codes already benefit from varying degrees of self-governance. In line with the scope of the SCR proposals, we propose to modify licence conditions relating only to BSC, CUSC and UNC. However, this does not necessarily preclude code modification proposals being raised to introduce or extend the scope of self-governance for other codes.

2.42. Appendix 3 contains more detail on our proposals for self-governance.

### 3. Role of Code Administrators and small participant and consumer initiatives

This chapter summarises the views of respondents to our initial proposals on the role of Code Administrators and small participant/consumer initiatives and sets out our Final Proposals. It also sets out the progress made on work to reduce the complexity and fragmentation of the codes. This work had been taken forward primarily through the Code Administrators Working Group, but overlaps with work on the role of Code Administrators, particularly in respect of the proposed Code of Practice for Code Administrators.

3.1. In this chapter we set out in more detail our Final Proposals for the role of Code Administrators and on small participant/consumer initiatives. By its nature this chapter includes a degree of detail on the modification procedures. We have therefore summarised the current position in the table below, which also shows the changes in our thinking since our Initial Proposals.

3.2. As with the Significant Code Reviews set out in Chapter 2, this chapter focuses primarily on the UNC, the BSC and the CUSC. However, we consider that the principles contained in the Code of Practice (CoP) can be generically applied, and it will be for the Parties to other codes to apply any best practice identified.

Initial Proposal	Final Proposal
Powers to 'call in' proposals - enabling the Authority to direct the Panel on modification timetables, necessary analysis and terms of reference for modification working groups. 'Send back' powers - allowing the Authority to formally return reports to the panel where we consider the analysis, legal text, or any other aspect of the report is deficient and inhibiting our ability to take a robust decision.	'Send back' only - the proposed 'send back' powers create the safety net if the quality of the proposal is not adequate. Existing 'urgent' procedures can already be utilised to ensure critical dates are met. We are not pursuing the proposed 'call in' powers.
Code Administrator ('CA') obligations to assist small parties - defined under licence as parties with fewer than 1 million supply points (i.e. point of connection rather than customers). CAs will be required to offer assistance on the fundamentals of the modifications process to these parties, such as understanding the implications of a proposal or help them raise one of their own.	Introduce CA obligations to assist interested parties, particularly small participants (which may include new entrants) and consumer groups. We propose a more general definition of small party which now relates to parties who are resource constrained and/or in particular need of assistance.
Code of Practice for CAs ('CoP') - establishment of common principles, procedures and templates to reduce complexity of operating across several	The CAs and more generally the code processes must adhere to the principles and more generally have regard to the CoP. We expect the CAs to review the

Initial Proposal	Final Proposal
codes and to ensure best practice is adopted by all CAs. The CoP will set out in a greater level of detail and prescription the services that we would expect of the Code Administrators acting in a 'critical friend' role.	CoP from time to time, for example in line with results of the Key Performance Indicators, with modifications being subject to the agreement of the Authority.
Ofgem to carry out periodic survey to gauge CA performance.	Introduce Key Performance Indicators ('KPI') for Code Administrators – CoP requirement for CAs to report to us on their performance against certain KPIs (both quantitative and qualitative) to be agreed with us, some of which will be common between administrators. This should allow a direct comparison of relevant performance and help to highlight 'good practice'. Panel's will be able to set additional code specific KPIs if they choose.
Better rationale for panel recommendations (and decisions) – a specific requirement that recommendations are made in a transparent and robust manner, with reference to the relevant objectives of the code.	No change from initial proposals – panels should be transparent and introduction of self-governance, with panel making decisions rather than simply recommendations reinforces this.
A voting right for consumer-appointed UNC Panel member(s). This will provide such representatives with rights to vote on the UNC Panel which are consistent with their rights under the BSC and CUSC.	Licence to require a Consumer Focus representative be appointed to the UNC Panel; with an option for Authority to appoint a further member if we consider a particular market sector is under represented.
Independent panel chairs – in order to provide a greater degree of scrutiny over panel actions, panel chairs be appointed by the Authority.	Where not already provided for we will require that panel chairs are independent of the relevant licensee, to be approved rather than appointed by the Authority – i.e. we will not prescribe selection criteria or undertake recruitment ourselves, but have a veto over an unsuitable candidate.

### **The 'critical friend' and assistance offered to small participants and consumer groups**

3.3. Our initial proposals listed initiatives that could be undertaken by the Code Administrator acting as a 'critical friend'. We consider this role will make the code modification process more robust. We also listed support which could be offered to small participants and consumer representatives in order to facilitate their participation in the governance arrangements. We consider there is a large degree

of overlap between aspects of the 'critical friend' role and the arrangements for supporting small participants and consumer representatives.

3.4. For instance, we have previously explained that at a high level we see the role of a 'critical friend' being that of a 'devil's advocate', testing the appropriateness of the analysis that is being contemplated and the strength of the conclusions that can be drawn from it. Of course this would also ensure that any issues or queries that have been raised by small participants or consumer representatives are appropriately addressed, regardless of whether they are able to physically attend subsequent work-groups and panel meetings themselves.

3.5. We previously set out our view that the 'critical friend' role encompasses two separate sets of activities; those that CAs are expected to undertake in respect of all modifications (primary activities) and those they would only undertake when asked to do so in response to requests from small market participants or consumer representatives (secondary activities).

3.6. We considered that a primary activity of a 'critical friend' would be to assess modification proposals to determine whether they were likely to have a significant impact on smaller participants and/or consumers and, if so, to alert suitable representative organisations of this fact.

#### Response to initial proposals

3.7. There was a general view that CAs already acted as 'critical friends'. A number were opposed to the idea of introducing a licence obligation, with most feeling that this could be achieved through the use of a voluntary Code of Practice or modifications to the code rules. One respondent suggested that a 'Signatories Charter' be introduced which would set out the party's rights and the CAs responsibilities.

3.8. A minority of respondents were supportive of the 'critical friend' role being introduced as a licence obligation, and that the activities should be provided on a 'reasonable endeavours' basis, though there were few comments on what those activities should be.

#### Ofgem's Final Proposal

3.9. To ensure consistency in the provision of 'critical friend' roles between CAs, we are proposing, through a new licence requirement, to introduce an obligation on CAs to comply with the Code Administration Code of Practice. Further detail on the Code of Practice is set out at the end of this chapter.

3.10. It is more difficult to define the scope of secondary activities for a 'critical friend' since by definition they are tailored to the situation and would only be undertaken on request of a small participant/consumer interest group. The Code of Practice sets out some examples of what these secondary activities could include and

we would expect them to be refined over time in light of operational practice. However, we envisage that as a minimum they would include providing:

- assistance to smaller participants and consumer representatives (where applicable) with the drafting of modification proposals (particularly with regard to legal text); and
- a plain English explanation of the arrangements to which the relevant sections of code relate.

3.11. We also consider that smaller participants and consumer representatives may suffer from an asymmetry of information compared to the larger participants. It will therefore also be the duty of the Code Administrator to provide access to such information, where reasonably available to them.

3.12. In Chapter 4 we set out our Final Proposal in relation to the governance of charging methodologies. While in the context of code modifications we envisage that the obligations placed upon the licensees will be provided by the CA (to the extent they are a different entity), in the case of charging methodology proposals it may be appropriate for the network operator to discharge the obligation directly, regardless of whether there is a separate CA. For instance, it may be appropriate for network operators rather than Code Administrators to provide the proponents of charging methodology modifications reasonable access to network data and aid understanding.

### **Definition of small participant**

3.13. We considered that in order to effectively discharge any licence duty to assist 'small participants' and limit the additional burden being placed upon them, CAs would need to understand what constitutes a small party and target their resources accordingly. We therefore sought to establish a clear and workable definition.

3.14. We proposed in initial proposals a definition which covers small suppliers and shippers, drawing upon the Supply Point Administration Agreement (SPAA) approach, whereby 'small participant' would include any gas or electricity supplier with less than 1 million consumers. We noted that all of the 'big 6' suppliers are significantly above this one million supply point threshold, while all other suppliers are significantly below it. We retained the definitions from the December document for small generator and small network operator.

3.15. While we acknowledged that there are some very significant organisations falling into the sub-one million supply point category, particularly those focused on the industrial and commercial sector, we considered that they will have a relatively small team of individuals dealing with UK gas and electricity regulatory and code issues. A greater risk was that the assistance would be withheld from a party we would ordinarily want to assist, because the definition had inadvertently excluded them.



### Response to initial proposals

3.16. Respondents generally did not consider that it was appropriate or necessary to distinguish between categories of participant in this way. Many respondents, including several outside of the 'big six' companies considered that this was unnecessary discrimination. The network operators and CAs also suggested that they will provide any assistance they can on a universal basis, regardless of participant size and do not consider that they would need to target assistance owing to lack of resource.

3.17. Respondents also suggested that defining a small participant might distract CAs from providing help to all interested parties. It was also suggested that this could result in parties with extensive resources, albeit focused in another market, being offered assistance while relatively small niche companies could be excluded.

### Ofgem's Final Proposal

3.18. Taking account of the views expressed by industry parties, we propose to retain explicit licence reference to small participants and consumer groups but not to seek to define such parties by reference to their size but rather to their need. This will ensure that the spirit of our proposals is adhered to without creating the potential to inadvertently deny a party any assistance they would otherwise have received.

3.19. We consider that the KPIs could be a useful tool in measuring whether the CA has discharged the objective requirements of the role, for instance by being able to demonstrate through positive feedback the extent to which they have assisted smaller participants.

3.20. We note that one respondent, themselves a small participant, suggested that the requirement should not simply be to alert smaller participants of proposals which may impact upon them, but to assess what those impacts may be. Whilst we consider that this would be a welcome value added service, it may not be reasonable to expect the CA to be able to do this in each case, not least because it presupposes an in depth knowledge of the small participants' businesses.

## **Consumer representation on the UNC panel**

3.21. In our initial proposals we noted that the right to vote is an important mechanism for allowing a consumer voice to be heard and enabling it to influence debates on commercial issues that have an impact on consumers. The ability to vote makes active engagement in the modification process both more likely and more important. We therefore proposed that a consumer body, namely the National Consumer Council (NCC), which operates under the name Consumer Focus, should be granted voting rights on the UNC panel, bringing the UNC arrangements into line with the BSC and CUSC. We also proposed that the Authority should have the option

of designating additional consumer bodies if we felt that a particular section of the market would otherwise be under-represented.

#### Response to initial proposals

3.22. The majority of respondents had some support for consumer voting rights, noting that it already exists on the BSC and CUSC. Some felt that any consumer representatives must be knowledgeable about the gas and electricity markets and must only be able to vote if the modification impacts on consumers. Consumer Focus confirmed that it would have no interest in self-governance proposals as by definition they would have only a trivial impact upon consumers. Some respondents felt that large consumers should have a voting representative on the UNC.

3.23. Some respondents were opposed on the basis that the UNC is an industry contract and that while the panel should record views of the consumer representative, only Code Parties should have a vote. Some noted that given the current balance between network operator and User seats, the composition of the UNC Panel would need to be reviewed.

#### Ofgem's Final Proposal

3.24. We remain of the view that a consumer representative on the UNC Panel will be able to offer views from the important perspective of the impact on consumers, who ultimately pay the costs associated with the operation of the gas trading arrangements. This view should be capable of being expressed as part of the recommendation on whether to accept or reject a proposal.

3.25. We also note the views of Consumer Focus that it will have no particular interest in those proposals which are identified as being for self-governance as they will, by definition, have little or no consumer impacts. We consider that Consumer Focus will have an important role in identifying self governance proposals, and will, as any other party, be at liberty to review its position once the consultation on a self-governance proposal has concluded.

3.26. While we recognise that Consumer Focus represents the interests of all customers, we consider that it would be prudent to provide the Authority with the option of appointing a further consumer representative. This may be appropriate where modification proposals would have different and potentially conflicting impacts upon various categories of consumers either now or in future, making it appropriate for those individual categories to be represented in addition to consumers in general. Our proposed licence drafting will therefore ensure both that Consumer Focus has a vote on the UNC panel and provide the Authority with the option of appointing a further voting consumer representative, should the need arise.

3.27. We note that UNC modification proposal 286 and alternative proposal 286A are currently out for consultation. Proposal 286 seeks to amend the UNC modification rules such that the two non-voting seats on the panel currently allocated to

consumer representatives are provided voting rights; it does not seek to amend any other aspect of the panel constitution or the rules more generally. Alternative 286A seeks to limit Consumer Focus to one seat on the panel and clarify that its vote does not extend to self governance proposals or non-modification business carried out under the auspices of the UNC Committee, which has the same membership as the UNC Panel<sup>5</sup>.

3.28. At this stage we do not consider it is appropriate to comment on these proposals other than to confirm that in our view neither conflicts with our proposed licence modification. Each proposal will be considered on its own merits, though in the case of either being implemented a further code modification may still be required in order to reflect the potential for a further consumer representative on the panel to be appointed by the Authority.

### **Independent Panel Chairs – CUSC and UNC Panel**

3.29. Our initial proposals suggested that an independent chair would provide a degree of independent oversight of Code Administrators, without requiring the wholesale structural reforms that would be required by a board or company structure. We noted that the BSC already has an independent chair appointed by the Authority under the terms of the BSC and suggested that it would be appropriate to extend this arrangement to the UNC and CUSC. We also proposed that the costs of the independent chairs are recovered through network charges, along with the more general costs of administering the code.

3.30. In our initial proposals we also noted that at present, the UNC chair does not have voting rights although the BSC and CUSC chairs have a casting vote on relevant motions, though these relevant motions are not defined<sup>6</sup>. We considered that with a move to independent chairs, it would be appropriate for all chairs to similarly be granted rights with respect to a casting vote, particularly in the case where the panel is tied. More generally, we consider that providing independent panel chairs with voting rights is an important mechanism for providing them with the authority to carry out their role effectively.

#### Response to initial proposals

3.31. There was general support for chair of the panel being independent, but several respondents raised concerns about the chair being appointed by the Authority. Some considered that this would impinge upon the independence of the chair, particularly with respect to any vote, or other influence they may have over recommendation on a proposal stemming from an SCR. Some considered that if the Authority appoints the chair, it should also fund their remuneration. Several

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<sup>5</sup> Further details, including the draft report on UNC286 'Extending modification panel voting rights to consumer representatives' and UNC286A: 'Extending modification panel voting rights to (a) consumer representative(s)' are available on the Joint Office website at: <http://www.gasgovernance.co.uk/0286>

<sup>6</sup> See BSC Section B 4.4.4 and CUSC Section 8.10.4.

suggested that DECC should instead appoint the chair. There was a minority view that there should be no independent chairs as this created an additional cost to operating code panels. One respondent stated that Ofgem should reconsider a requirement for independent boards overseeing the operation of the CA, while another recommended a 'Community Interest Company' should provide administration services.

3.32. While those who provided specific comments were not supportive of the chair of the UNC and CUSC having a casting vote, all of those comments were in relation to the casting vote were provided in context of recommendations on SCR proposals. They considered that it would be inappropriate for an individual appointed by the Authority to potentially determine whether an SCR proposal was exempt from appeal to the Competition Commission or not.

#### Ofgem's Final Proposal

3.33. Whilst we do not agree that the appointment of a chair by the Authority would in any way undermine their independence, we do recognise that there may be alternative ways to select such an individual. We therefore propose to retain the requirement that each of the main codes has an independent chair, but we will not seek to prescribe how that chair should be selected. Instead, it will be for the licensee, having particular regard to the views of the relevant panel, to ensure that they have discharged the requirement that the panel chair be independent. At this stage, we consider that the Authority should have a right of veto over any candidate put forward by the licensee.

3.34. We consider that this is an aspect of code governance that could be subject to future review once our Final Proposals have bedded into practice.

3.35. We have noted the concern that the independent chair's casting vote should not be able to determine whether or not an SCR proposal is subject to appeal. We note that a casting vote is only relevant where there would otherwise be deadlock and the panel is required to make a determination. We do not consider that a casting vote is necessary in the case of a recommendation, which can legitimately reflect a split vote without hindering the ongoing progress of a proposal; it will simply be recorded as such in the modification report to the Authority. However, in the case of self-governance, failure to secure a majority view could result in deadlock and impede effective governance. There may be matters other than decisions on self-governance proposals which are also subject to panel determinations. We therefore consider that our proposals are consistent with the intent of a chair's vote on relevant motions, in particular those of the CUSC which specifically excludes the chair's vote from being cast in relation to a panel recommendation on a modification proposal.

3.36. At this stage, we consider that the voting rights of the chair should appropriately remain a matter for the relevant code rules as set out above and have therefore not sought to prescribe how a casting vote should operate. We anticipate that licensees and other Code Parties will consider this point further when developing

their proposals for a self-governance decision model and bringing the three main codes closer into alignment.

### **Call in and Send back powers**

3.37. Our initial proposals included “call in” and “send back” powers for the Authority and discussed how they could operate. We considered that the ‘call in’ powers could enable the Authority to expedite modification proposals which were not being effectively developed or assessed at a speed (for example by requiring meetings to be condensed into shorter duration) which was consistent with their importance, or to influence the Terms of Reference for the assessment of the proposal.

3.38. We considered that in practical terms the ‘send back’ powers would enable the Authority to send back a final modification or amendment report to the panel in circumstances where the Authority considers that the analysis contained within the report is deficient and requires further work to be undertaken. This could include requiring the panel to reconsider the report in light of new information.

#### Response to initial proposals

3.39. There was a general feeling from respondents that Ofgem would not require ‘call in’ or ‘send back’ powers if Ofgem were more active in the modification process. Some felt that the powers would introduce a new level of uncertainty as interested parties would not be sure if and when Ofgem might make use of them.

3.40. There was support from respondents for ‘send back’ powers as they felt the power might be a useful ‘last resort’ option on occasions where the normal modification process had failed for whatever reason.

#### Ofgem’s Final Proposal

3.41. We remain of the view that the timeliness of assessment is an important issue. While the length of assessment should be proportionate to the complexity of the issue, we also consider that this should be balanced against the benefits of an early resolution of the issue. The current modification procedures are dependent largely upon the goodwill and availability of those individuals who willingly provide their time and expertise, and we have noted elsewhere in this review that this can be a burden, particularly for the smaller participants. It therefore seems that condensing meetings into a shorter duration may not always be a viable or appropriate means of expediting a process. However, we consider that there may be other tools at the panels’ disposal which are not fully utilised, such as greater use of ex-committee work or the use of consultants and other technical experts. The feasibility of such an approach should be considered on a case by case basis and we consider that the panels are best placed to do that. We consider that this should be enhanced through increased rigour of the panel, as facilitated by the independent chair and increased engagement from Ofgem.

3.42. There are existing rules in place, at least in the case of the BSC and CUSC which provide a formal opportunity for us to influence the modification timetable if we consider that it is inappropriate. We also expect that in the absence of a formal rule the UNC panel would act reasonably and respond to such concerns if we raised them in relation to a modification to that code. Parties who propose modifications also have the opportunity to voice their concerns if they consider that their proposal is not making adequate progress. In extremis the urgency procedures provide a safeguard to ensure that a modification report can be presented to the Authority in time for its decision to be made by a particular date. We consider that such status need not be granted only at the beginning of the process, but that a matter can become urgent, either through lack of sufficient progress or external events making matters more pressing.

3.43. Given the range of potential measures outlined above, we do not think it is necessary at this time to provide for additional powers for the Authority to 'call in' a modification report, and this does not form part of our Final Proposals. However, we do consider that the 'send back' proposal remains appropriate.

3.44. We remain of the view that the 'send back' provisions will provide an effective safeguard against the Authority being placed in a position where it is unable to accept a proposal, not on its merits, but owing to deficiencies in the report such as an insufficient assessment, incorrect legal text or other technical flaws. We agree with those respondents who suggested that this should be a rarity and that Ofgem should endeavour to raise concerns at an earlier stage in the process. However, there may also be occasions where new issues come to light which could not reasonably have been foreseen by the panel or Ofgem, but are later identified as having a bearing on the decision. We anticipate that this should also be a rare event, but that this seems to be preferable to otherwise having to reject a proposal on the basis that its assessment, if not the proposal itself, has been superseded.

## **Panels to provide reasons for decisions**

3.45. Whilst the practice for providing recommendations is similar across each of the three main codes, they do differ in the extent to which they make explicit reference to the relevant objectives, the extent to which the reference to the relevant objectives is detailed in nature, and the degree to which comments are attributable to individual panel members. In our initial proposals we set out that we considered panel recommendation to be an integral part of the modifications process. We set out that Panel members should act in a transparent manner and, to the extent they are required to represent the views of others, should be accountable for their voting decisions. We consider that this is even more important in the context of self governance, where panel members will be voting to decide upon the outcome of a proposal rather than simply making a recommendation.

### Response to initial proposals

3.46. All sectors of the industry supported the principal of requiring panels to provide their reasons for recommendation to the Authority, though there were differing views

on the form the reasons should take. Some respondents felt that it should be recorded as the consensus reasoning of the Panel as a whole, whereas others felt that individual members' views should be recorded in the modification report to the Authority.

3.47. However, there was near unanimity that this did not require a licence modification, with only Consumer Focus disagreeing. Respondents generally felt that a licence condition was unnecessary and disproportionate, particularly as some panels (notably BSC) already adhered to this practice. A number suggested that a modification to the code rules would achieve the same result, while others considered that guidance on the recording of recommendations could be set out in the Code Administration Code of Practice.

#### Ofgem's Final Proposal

3.48. We remain of the view that licence changes requiring the provision of transparent reasons is a proportionate response to this issue. We consider this would enhance transparency and should help to ensure that rigorous and high quality analysis is undertaken on the relevant code modification proposal. We consider that, as the requirement to provide a recommendation is already a feature of the licence provisions, an alignment to specify that they be based on an assessment of the relevant objectives adds clarity rather than imposes an additional burden. More importantly, we consider that this will ensure that the panel's decisions made under the self-governance framework will be equally transparent and robust, being made on the same basis as if they had come to the Authority for a decision.

3.49. We consider that panels should provide reasons for their recommendations and that these reasons should be expressed in relation to the relevant objectives of the code in question. At present, even where the rationale for a decision is provided, it can require a collation of the final report, the panel minutes and a separate record of votes in order to get a complete picture. The reasons for the panel's recommendation should appear in the final modification report which is submitted to the Authority, or in the case of self-governance proposals, in the panel's decision document. We have therefore proposed revised drafting to explicitly align the requirements of the main three codes rather than rely on custom and practice.

### **Key Performance Indicators (KPIs)**

3.50. In our initial proposals we indicated that some form of performance 'scorecard' would be the most appropriate way of introducing performance evaluation measures, and suggested that this could be undertaken by Ofgem. We also noted that Elexon regularly undertakes customer surveys<sup>7</sup>, and that the Joint Office has in the past undertaken such an exercise.

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<sup>7</sup>[www.elexon.co.uk/documents/Publications/CustomerSatisfactionSurvey/ELEXON\\_Customer\\_Survey\\_2009\\_Results.pdf](http://www.elexon.co.uk/documents/Publications/CustomerSatisfactionSurvey/ELEXON_Customer_Survey_2009_Results.pdf).

3.51. We also suggested that one means of ensuring performance may be to require the relevant CAs to attain, and thereafter maintain, ISO 9001 accreditation; a recognised standard for an organisation's internal Quality Management.

#### Response to initial proposals

3.52. Some respondents suggested that the evaluation of CA performance should be a matter for the code parties, not Ofgem. One respondent supported the suggestion but considered that Ofgem should also be subject to the scorecards. Several respondents commented that they would support the proposal as long as the requirements were meaningful and relevant. Another, while supporting the proposal, suggested that it should be a 'light touch' to performance evaluation as there was a risk that CAs might put the aims of the scorecard above the objectives of the code. One respondent felt that the KPIs should be decided by Ofgem and the code panels. They thought that the evaluation should be done by an independent agency, and action plans decided in light of the results. They suggested an alternative solution would be to put the administration of the codes out to tender every 5 years.

3.53. Three respondents considered that the scorecards would not have a significant influence on CA performance and would simply add to costs. Another felt that CAs were more likely to change behaviour in response to the Code of Practice than as a result of the scorecards. Some commented that CAs already undertake periodic customer surveys and that these existing processes could be used to influence what the scorecard could look like. Another felt that this should only be necessary for CAs who are independent, particularly if the service is procured following a tender process.

3.54. While there was some support for the suggestion that CAs achieve ISO accreditation, others suggested that this should be a matter for code parties to pursue. Some respondents also suggested that we had under-estimated the costs of achieving and adhering to the standard.

#### Ofgem's Final Proposal

3.55. In our Final Impact Assessment we have set out the quantitative and qualitative benefits of implementing these proposals. We remain of the view that regular benchmarking would improve transparency on the relative performance of the CAs and increase accountability for costs and quality of service. Whilst the initial proposals suggested that this could be achieved through an Ofgem-led survey perhaps every one or two years, we now propose to require the CAs to report on their KPI performance to us, and to the relevant panel.

3.56. In order to allow for an assessment of comparable performance, it will be appropriate for each of the CAs to adopt a common set of core KPIs, though this does not preclude additional, code-specific KPIs, being developed at the relevant panel's request. We consider that the results of this KPI reporting may be a benefit of itself, for example by helping to incentivise CAs to identify and adopt best practice and therefore acting as a catalyst for future review/revision of the Code of Practice.



3.57. We consider that there will be additional benefits if these KPIs facilitate comparable performance between CAs. Given this, and the complementary relationship between KPI performance and future revisions to the Code of Practice, we consider that the common KPIs would appropriately be set out in that document. We have today published an open letter consulting on the Code of Practice and set out our thinking in greater detail therein.

3.58. While we remain of the view that ISO accreditation could be a valuable benchmark. We also recognise that, to the extent that this accreditation is a recognised mark of quality, it could provide enduring incentives upon CAs to maintain standards. However, we have noted the concerns of some respondents that the expense of attaining and maintaining accreditation may not in all circumstances be justified. We therefore do not propose to pursue this as a requirement, but note that licensees, Code Parties and the CAs themselves are at liberty to pursue this further.

## **Code of Practice**

3.59. In our June 2008 document setting out the scope of the CGR we stated that one aspect of the review would be to seek to reduce the complexity and fragmentation of the existing governance arrangements. We noted that the existing arrangements result in complexity for all market participants, but present a particular barrier to new entrants and smaller participants seeking to engage in codes processes. We considered that removing barriers to entry for these parties is likely to promote competition and should stimulate innovation within the codes regulatory framework.

3.60. The Code Administrators' Working Group ("CAWG") was therefore established in order to explore and progress opportunities for the convergence of code modification processes. The aim was to identify opportunities to bring the codes into alignment, which could be realised without structural change, for instance through modification to the existing rules or simply changing custom and practice. The CAWG provided Ofgem with its interim report in early 2009. This report contained several recommendations and principles that should be adopted for code administration.

3.61. Following our initial proposals, the CAs of the BSC, CUSC and UNC produced a draft Code of Practice (CoP). This document built upon the principles agreed by the CAWG, adding a level of detail on how the principles would be adhered to. The draft CoP sets out a standard process that each of the three main codes should follow, simplifying the process for casual code participants who would otherwise have to familiarise themselves with differing sets of rules and procedures. The Administrators also produced a set of standard templates to provide further guidance and simplify the process by which industry participants can propose changes to the codes. The CoP also sets out the practical measures that the CAs will be expected to undertake in discharging their obligations to act as a critical friend and provide assistance to participants, as set out above.

3.62. The CAWG was reconvened in November 2009 in order to consider the draft CoP and subsequently endorsed the document at its meeting of 11 December 2009. The CAWG also endorsed the draft templates to accompany the CoP, recommending that the CoP be subject to wider industry consultation and revised as appropriate. We have today published the draft CoP and invite comments upon it by 10 May 2010.

3.63. In our initial proposals we consulted on whether the CoP should be voluntary. We set out that if voluntary arrangements are ineffective in delivering a greater degree of convergence and consistency in code change practice we would consider moving to a binding document. We remain of the view that the CoP should set a high level framework for code procedures and practices and be flexible enough to be amended in light of lessons learnt. However, in line with respondents' views in relation to this proposal but also in relation to other strands of the CGR, we have placed a greater importance on the CoP to deliver effectively several of the policy initiatives stemming from the CGR and the CAWG. One of the objectives of the review has been to reduce fragmentation and it would therefore be inappropriate to require compliance by all parties with both the modification rules and separately the CoP, effectively meaning the rules are split across two different documents. However, we do consider that the CAs should be required to adhere to the CoP principles.

3.64. Our Final Proposal requires the relevant licensees to have regard to the CoP and accord/be consistent with the principles contained therein, when fulfilling their obligations pertaining to the affected industry codes.

## 4. Governance of Charging Methodologies

This chapter summarises the views of respondents to the proposed reform of the governance of charging methodologies and sets out our Final Proposals. We confirm that we propose to incorporate the charging methodologies into the relevant industry codes. This will apply to gas and electricity transmission connection and use of system charging and to gas distribution use of system charging. Electricity distribution use of system methodology governance arrangements have previously been addressed under the structure of charges project.

4.1. The charging methodologies developed by network owners and operators (NWOs) have impacts upon both the operational and siting decisions of market players, as well as having significant distributional effects. Under the existing charging methodology arrangements network users and customers are not able to formally propose modifications to the charging methodologies. As part of the CGR we consulted on the principle of whether charging methodologies should be open to change by network users (and customers) and on the options for opening up the charging methodologies.

4.2. We indicated that there may be advantages to changing the governance arrangements, particularly in terms of improving accessibility and transparency of the charging methodologies to users, as well as the accountability of the network owners and operators. In particular we indicated that opening up the charging methodologies should enable network users and customers to bring forward innovative changes and address any deficiencies in existing methodologies. This might lead to improvements in cost reflectivity which should promote competition between network users, ultimately to the benefit of customers.

### The Governance Options

4.3. In August 2009, we issued our initial proposals consultation document (“the August consultation”) for the governance of charging methodologies. We set out four options: Option 1, maintaining the status quo; Option 2, modify the current licence regime; Option 3, industry code governance; and Option 4, development of a new charging methodology code. Based on responses to our earlier consultation and the cost benefit analysis undertaken by Frontier Economics, we proposed that either Option 2 or Option 3 would be viable, discounting Options 1 and 4. Options 2 and 3 were described as follows:

- **Option 2: Modify the current licence regime.** Under this option, network licences would be modified to enable network users (and customer representatives) to raise modifications to the charging methodologies. The NWOs would be required to assess and consult on these proposals and ultimately submit them to the Authority for decision.
- **Option 3: Industry Code Governance.** Under this option, the specific charging methodologies would be transferred into (i.e. explicitly stipulated in) the relevant industry code. Parties to the industry codes would be able to raise a proposal to

change the charging methodology as expressed in the code. The proposed changes would then be assessed by the relevant code panel and submitted to the Authority for decision.

#### Responses to the initial proposals

4.4. The strong majority of respondents considered that there should be a departure from the current arrangements. Of those in support of change, the majority supported our Option 3, citing in particular the benefits of being able to align charging with code modifications and the ability to refer an appeal to the Competition Commission. One respondent noted that the charges derived from charging methodologies have a "critical impact on the costs, incentives and information that users have at all levels of the market". This respondent agreed that Option 3 will enable a more co-ordinated process for developing charging methodologies and is consistent with developments associated with the common electricity distribution charging methodology.

4.5. Some respondents, including the CUSC Panel, supported an Option 3 approach to governance on the basis of the experience of the Transmission Access Review, where it proved necessary to widen the scope of the CUSC working group to include discussions on the associated charging methodologies. Whilst this had benefits in terms of transparency, operating under dual governance was also problematic for the group and respondents felt that the experience lends weight to formally incorporating the charging methodologies into the respective code.

4.6. Several NWOs considered that the current arrangements are working well and that as they already have established discussion forums, e.g. Distribution Charging Methodology Forum (DCMF), and have an obligation to consult users, then no radical governance reform was necessary.

#### Ofgem's Final Proposals

4.7. We have considered the responses from the industry and we propose that the most appropriate governance regime for the management of charging methodology modifications is Option 3 (industry code governance). We agree with a number of respondents that utilising the relevant industry code governance process would be the most efficient and transparent mechanism going forward. In combination with the proposals set out above in relation to CAs, we believe that affected parties will be able to draw on support/help from the CAs should they wish to pursue a proposal.

4.8. Option 3 provides the opportunity for affected parties to challenge the Authority's decision on a charging methodology modification via an appeal to the Competition Commission where the Authority's decision diverges from the Panel's recommendation. Given the potential impact of charging modifications on industry parties, we consider it appropriate to provide an independent and objective route for parties to challenge the Authority's decisions in this area.

4.9. Option 3 will also allow for closer alignment and a more holistic consideration of the charging implications of any associated code modification.

4.10. We believe that the existing charging methodology forums<sup>8</sup> should continue to be the main arena for discussion of issues relating to the methodologies and may provide an appropriate venue for a modification to be developed if referred there by the code panel.

4.11. It should be noted that to bring Option 3 into effect will require the industry to bring forward the appropriate code modification(s). We discuss the timeframe for the development of modification proposals in Chapter 7.

### **Scope of the proposals**

4.12. In our August consultation we proposed that we would undertake reform of the arrangements which relate to transmission first, but would welcome views on whether or not to undertake reform within the gas distribution sector at the same time, or at a later date. This was in line with our impact assessment which indicated that the greatest benefits were likely to accrue in relation to transmission, largely owing to the impact of projected expenditure on transmission infrastructure.

#### Response to initial proposals

4.13. National Grid considered that the transmission sector is best placed to take advantage of the benefits outlined in our August consultation and considered that there may be advantages in assessing the benefits of the governance reform in this sector prior to rolling out these changes within gas distribution. The GDNs which are not owned by National Grid opposed reform being introduced to gas distribution charging at this time as they considered the existing arrangements worked well.

4.14. The views from users were mixed, though the majority also supported a phased roll out, focusing on transmission first. Conversely, one supplier felt that the priority should be based on the relative financial impact of particular charges on customers and therefore believed that the order of priority should be gas distribution, electricity distribution then transmission. This supplier raised a concern that Ofgem is placing too much emphasis on transmission issues. Consumer Focus stated that there was no benefit in delaying reform in gas distribution, particularly given reforms already underway in electricity distribution.

4.15. In addition, a number of NWO responses to the illustrative licence drafting that we published in October 2009 raised concern over the inclusion of connection charging methodologies, and in particular gas distribution connections, within the proposed scope of the governance model. NWOs noted that as shippers and suppliers are not involved in the connection process, it would not be appropriate to subject the

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<sup>8</sup> The Transmission Charging Methodology Forum (TCMF) Forum and the Distribution Charging Methodology Forum (DCMF).

Connection Charging Methodologies (CCMs) to the code governance arrangements as the codes are essentially shipper/supplier contracts.

4.16. NWOs also suggested that this governance model would raise competition concerns. They were concerned that, given the contestable nature of connections the inclusion of connection charging in code governance arrangements would entail competitors discussing their charging arrangements.

#### Ofgem's Final Proposal

4.17. Having given careful consideration to the arguments set out above, we propose to include the governance of gas distribution Use of System (UoS) charging methodologies within the new regime at the same time as the transmission roll out. Open governance on charging methodologies across all sectors will bring the merits of accessibility, transparency and accountability. However, for the reasons set out below, we believe that governance reform of the distribution connection methodologies (electricity and gas) should be progressed outside this CGR project.

4.18. We consider that Option 3 represents the most appropriate way forward. This option would subsume CMs into existing codes. The advantage of this approach is that those codes already have robust and soon to be improved governance arrangements. We consider that a key requirement is that the code already encompasses the relevant parties. Given that end users are party to the CUSC, incorporation of electricity transmission connection charging will provide those end users with the same ability to propose changes as any other party of the CUSC. We also consider that as the majority of connectees to the gas National Transmission System (NTS) are either shippers, or will have strong contractual relationship with a shipper, gas Transmission connection charging methodologies can appropriately be accommodated in the UNC. The same is not currently the case for distribution connections where often the connecting party will be a housing developer who will have a one-off relationship with the distribution network; developers are very unlikely to be parties to the relevant codes. There are exceptions to this, such as distributed generation, new gas entry such as biogas, gas storage or independent networks, where the network user is more likely to be a code party and have an interest in both the connection and on-going use of system charges. However, at this time we are not including distribution connection charging methodologies within the CGR proposals.

4.19. Currently consideration is being given to commonality of the electricity distribution CCMs methodologies and their governance. We believe that there would be value in considering the commonality of gas distribution CCMs and their governance alongside that of electricity.

4.20. We remain of the view that all CCMs should be subject to open governance arrangements. However, we consider that further thought needs to be given to the governance arrangements for distribution connection methodologies in light of the issues discussed above.

## Mitigation measures

4.21. We acknowledged in the August consultation that there is a risk in opening up the methodologies to market participants. There is a risk that parties will raise a significant number of charging modification proposals that will increase administration costs and result in regulatory uncertainty. It could also create the potential for increased volatility of charges and revenue volatility to the NWO businesses, with greater risk of over and under recovery of revenues.

4.22. We therefore set out a number of measures to mitigate the potential costs and risks. These included a 3 or 4 month annual/bi-annual windows for change; annual restrictions on the numbers of changes that could be brought forward; and, a minimum threshold of declared support before a proposal could be taken forward.

### Response to initial proposals

4.23. Whilst there was overwhelming support for either an annual/bi-annual window, most respondents suggested that this measure would do little to limit the number of modifications being proposed. However, NG considered that the window would go some way to aiding planning and allow for rationalisation of multiple modifications. A supplier expressed concern that the window could lead to a flood of proposals in a short space of time, and would prefer that the windows instead refer to implementation dates, i.e. lock in a methodology for at least 6 months.

### Ofgem's Final Proposal

4.24. We agree that a change window, i.e. a window for submitting proposals, will not in itself reduce the number of modifications being proposed, but we remain of the view that a robust modification management and implementation procedure should be adopted. Also, we expect that such a procedure should go some way to enable NWOs to plan effectively work on proposals and to rationalise parallel proposals where appropriate.

4.25. We have retained the existing licence obligations which require the NWOs to generally only effect charging changes at specific times within a year. Therefore we will expect the network operators to adopt a process that would allow them to adhere to the obligations given that their charging methodologies will be subject to open governance. We believe that there may be merit in adopting a 3 month change window however we believe that the NWOs should develop a process that allows them to fulfil all their charging related obligations.

4.26. We consider that this process will be self policing to an extent due to the administrative burden but also the number of modifications will be limited by the amount of available information on NG's costs and models. It is possible that proposal ideas brought forward by other parties will need to be fleshed out in conjunction with the network operator and the appropriate charging forums. In

addition there is always the opportunity to group potential charging modifications through an SCR process if we considered this became a significant issue.

## **Affected parties**

4.27. We proposed that the right to raise proposals should be open to parties who are materially affected by the charging methodology. As this potentially extends beyond the parties to a particular code and beyond the obvious consumer representative bodies, we suggested that the Authority would additionally have the ability to designate such persons for the purposes of raising a modification proposal.

### Response to initial proposals

4.28. Of the respondents that commented, the vast majority were supportive of our proposed approach. NG believes that the arrangement to designate an affected party may already be catered for in the UNC and CUSC, and would be extended to charging methodology proposals under an option 3 (industry code governance) approach. However, a minority of respondents suggested that changes should only be proposed by Parties to the relevant code.

### Ofgem's Final Proposal

4.29. The objectives of the reform of the charging methodology governance arrangements are to promote transparency, accessibility and accountability of the NWOs for their charging methodologies. As discussed above, charging methodologies can have a direct impact on parties that currently do not have any direct influence on the methodologies. We believe that Option 3 provides the most robust governance arrangement to allow third parties to propose modifications to the NWO charging methodologies.

4.30. We recognise that not all affected parties are signatories to the relevant industry code. Therefore we will consider designation of a non-code party where they can demonstrate that they are materially affected by a charging methodology and are seeking to propose a modification. We believe that adopting this way forward will further mitigate the risk of spurious and vexatious proposals being put forward and allow us to independently assess whether the party is genuinely affected.

## **Authority decisions**

4.31. Currently the Authority is obliged to make its decision on whether to veto a charging methodology proposal within 28 calendar days of its receipt, or within 3 months if it chooses to undertake an Impact Assessment (IA). For industry code modification decisions we have adopted a self imposed KPI of 25 working days with an open ended timeframe if we undertake an IA. One of the key benefits of subsuming the charging methodologies within the industry codes is the holistic consideration and development of the charging methodologies with, where



applicable, the associated code modification. It would therefore be inappropriate to retain differing decision timeframes.

#### Response to initial proposals

4.32. Two respondents raised concerns about the open-endedness of Ofgem decision making timeframe under Option 3, suggesting that it could add further regulatory uncertainty to the process, as opposed to the existing 'veto' regime. One suggested that a maximum 3 month decision making framework for both charging methodologies and industry codes should be adopted.

#### Ofgem's Final Proposal

4.33. We are cognisant of the impact charging methodology and charging changes have on the industry and will ensure that decisions will be made in a timely manner. We consider it appropriate to adopt the existing code decision making framework, which has a 25 working day KPI, for charging methodology decisions to make the processes consistent and gain the benefits of holistic consideration of code and charging modifications where appropriate.

4.34. Currently where the implementation of a modification is related to a time related event the panel/industry have the option to progress the proposal via urgency procedures. We consider that these arrangements could also be applied to charging methodologies (subject to the code modification rules being suitably drafted).

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## 5. Environmental assessment and the Relevant Objectives

In this chapter we set out our Final Proposal in respect of requiring the relevant code panels to make an assessment of Green House Gas emissions as part of their deliberations on whether to recommend acceptance or rejection of a modification proposal.

### Background

5.1. In June 2008, we issued guidance to industry participants specifying that the costs of greenhouse gas (GHG) emissions should be taken into account by industry in evaluating and assessing code modification proposals. However, while the industry has taken steps to incorporate the guidance into procedures, we considered that there was a continuing perception of this being desirable rather than essential. There was also some uncertainty on whether this guidance was limited only to emissions or other environmental impacts, such as upon flora and fauna.

5.2. In November 2008, we therefore consulted on whether:

- the principles set out in Ofgem's guidance should be expressly reflected in the licences governing the codes, placing an explicit requirement on parties to consider GHG emissions against the relevant code objective governing economic and efficient network operation; and
- requirements should extend to broader environmental issues in addition to GHG impacts.

5.3. Many respondents to the November 2008 consultation considered it unnecessary to amend the existing licences on the basis that the existing framework was suitable for conducting an assessment of GHG impacts. Others, notably the BSC panel, believed that a licence modification could be used to make the framework clearer and to reduce uncertainty over the panels' vires. There was an overwhelming view that the scope of the modification to code objectives and guidelines should be limited to GHG impacts, which are readily quantifiable, it was considered that the panels may be unable, without spending a disproportionate cost, to properly assess broader impacts such as on flora and fauna

5.4. In June 2009 we issued an open letter inviting views on a draft modification to the licence conditions pertaining to the UNC, BSC and CUSC. We noted that if the proposals were adopted we would progress similar modifications to the other industry codes that are subject to the guidance on GHG emissions.

### Responses to the Open Letter

5.5. We received 12 responses to the June consultation. Six respondents (the CUSC Panel and five with network businesses) stated that the licence modification was not necessary. However, the CUSC panel suggested that, notwithstanding the question

of necessity, it would be supportive if the modification was introduced. Other respondents indicated they would accept the licence modification if pursued.

5.6. While several respondents welcomed confirmation that the assessment would only be required "where applicable", some felt that this was still not sufficiently clear and requested further guidance. The majority of respondents agreed that we should not extend the panel's decision-making framework to take into account broader environmental issues.

## **Recent Developments**

5.7. On 15 December 2009, we published our revised guidance on Impact Assessments. This document takes account of best practice as it has developed, for instance in relation to sustainability issues, and it sets out Ofgem's approach to cost-benefit analysis. This guidance makes clear that Ofgem will have regard to the July 2009 Government guidance on carbon emissions. The guidance<sup>9</sup> sets out a revised 'dual pricing' approach to valuing carbon depending on the sector affected by the policy under development. Where policies reduce or increase emissions in sectors covered by the EU Emissions Trading Scheme (ETS), a 'traded price of carbon' will be used to value the impact of the policy. In all other sectors, a 'non-traded price of carbon' will be used. The main change is therefore that changes in the non-traded sector should be valued at a new 'non-traded price of carbon' rather than the Shadow Price of Carbon (SPC)<sup>10</sup>.

## **Ofgem's Final Proposal**

5.8. We remain of the view that there are benefits in amending relevant licence conditions with a view to expressly providing that industry and code panels assess (where applicable) the economic impacts of GHG emissions in considering code modifications. We propose to progress with changes to the network licences which govern the BSC, CUSC, UNC, DCUSA, UNC for IGTs, the STC, the Grid Code and Distribution Code. Assessment will be required, where applicable, under the efficient and economic network operation code objective or related objective.

5.9. Our guidance to industry on the assessment of GHG emissions in code modifications, mentioned above, has been amended in line with this best practice, and in particular the changes to the valuation of carbon, and we have included the revised document as appendix 4 to this document.

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<sup>9</sup> The guidance is available on the Ofgem website:

<http://www.ofgem.gov.uk/About%20us/BetterReg/IA/Documents1/REVISED%20GUIDANCE%20ON%20IMPACT%20ASSESSMENTS%2015%20DECEMBER%202009.pdf>.

<sup>10</sup> The non-traded price of carbon is based on estimates of the marginal abatement cost required to meet the UK's non-traded sector emission reduction target. In contrast, the SPC captures the damage costs of climate change caused by each additional tonne of greenhouse gas emitted as well as reflecting the policy and technological environment.

## 6. Timing Out

This chapter addresses our final views on the issue of “Timing Out” of code modification decisions. This has been consulted on by Ofgem outside of the Code Governance Review but, given recent code modifications that have been raised which seek to address the issue; this chapter sets out our final views and next steps.

6.1. Whilst not part of the CGR itself, we have in parallel pursued actions to address the situation where a proposal may ‘time out’ if the Authority has not made its decision by the stipulated date in the Final Modification Report. This situation arose in relation to a number of modification proposals to the BSC relating to transmission losses. A judicial review was brought which challenged whether the Authority had the power to make a decision after the ‘decide by date’ set out in the modification report. The High Court determined that the Authority did not have the power to approve such modifications. Although we have previously consulted on licence modifications to address this risk, given recent developments and considering the views of respondents to those consultations<sup>11</sup>, we consider that licence modifications at this time are unnecessary.

6.2. National Grid has raised BSC proposal P250. Under that proposal, while the BSC Panel will still be able to set a preferred implementation date, the fall back implementation date will be triggered by reference to the Authority decision date (for example, implementation being 15 working days from the Authority decision date), which remains open ended. The intent of the proposal is to remove the timing out risk. While this is already common practice under the CUSC, and whilst the UNC implementation date is generally determined by the relevant Gas Transporters post direction, National Grid has also raised CUSC and UNC modification proposals to bring all three codes into line<sup>12</sup>. In addition, under P250, it is proposed that the BSC panel will be able to write to us if it feels that circumstances or elapsed time impacts upon the validity of its analysis.

6.3. We recognise that this is a level of procedural detail that needs to be set out in the modification rules, and any licence modification would have required a subsequent modification proposal in order to be given full effect. Although we will consider each modification proposal on its merits and nothing in this document should be considered to pre-empt or fetter the decision of the Authority, we welcome the willingness of industry parties to directly address this problem of timing out. Given the actions taken by National Grid in seeking to address this issue we do not consider that a licence modification is necessary at this time, though we may revisit this decision once these modifications have reached a final conclusion.

<sup>11</sup> Two consultations were issued on licence modifications to address the timing out issue: in November 2008

(<http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/Open%20letter%20on%20implications%20of%20losses%20JR%20FINAL%2020081118.pdf>) and in May 2009 ([http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/timing%20out%20issues%20open%20letter%20\(2\).pdf](http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/timing%20out%20issues%20open%20letter%20(2).pdf)).

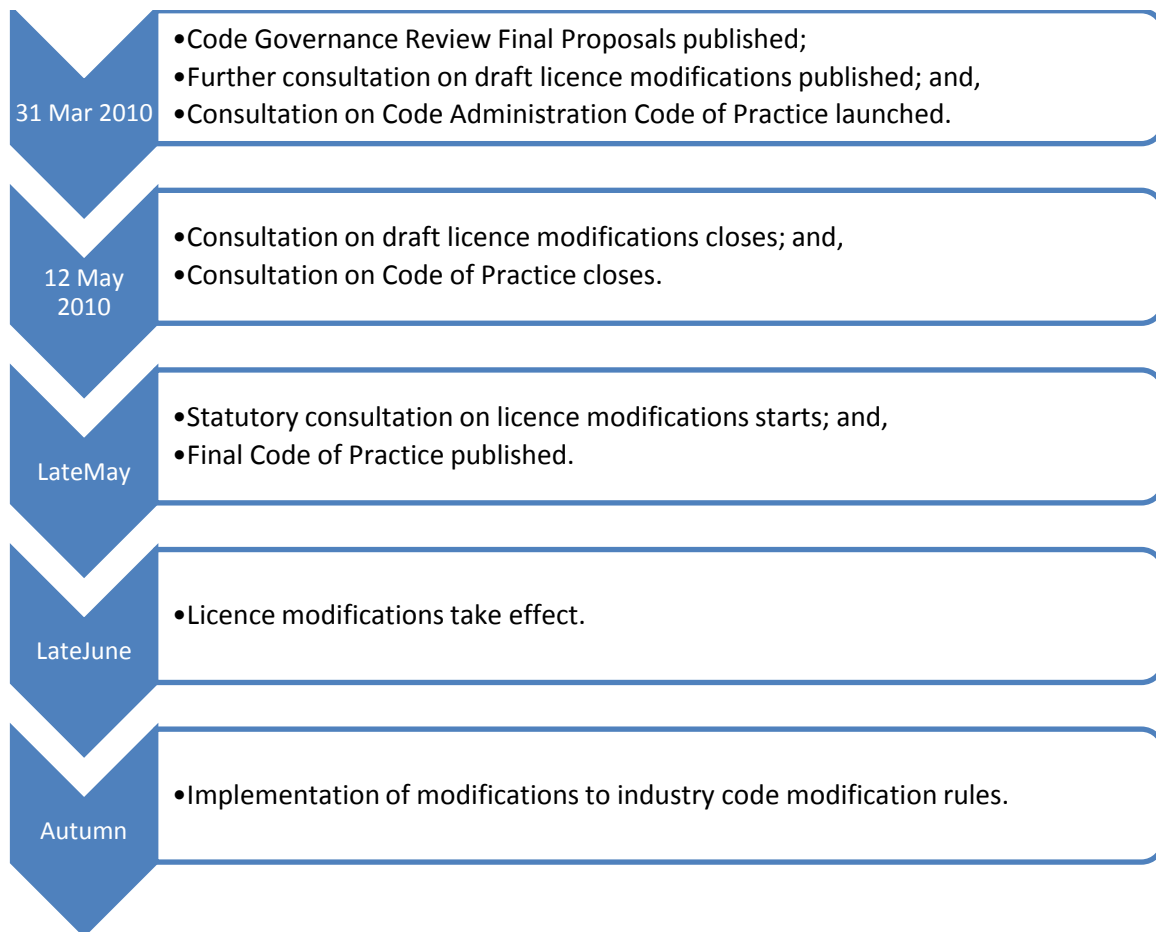
<sup>12</sup> CAP179, UNC281 - Prevention of “Timing Out” of Authority decisions on Modification Proposals.

## 7. Way forward

This chapter sets out our proposed way forward, including further deliverables of the Code Governance Review and subsequent actions required of relevant licensees and other parties in order to give full effect to the proposals.

7.1. This paper sets out our Final Proposals for the reform of industry code governance arrangements. We recognise however, that a significant amount of work is still required for these reforms to be given full effect and the benefits realised. Below we describe the next steps in the reform process.

### Indicative timetable:



### **Draft licence modifications consultation**

7.2. A further consultation on the draft licence modifications was published today. Given that previous opportunity has been taken to comment on the proposed drafting (see responses to our open letter dated 27 October 2009) and Ofgem's

intention to hold a workshop to discuss the proposed licence modifications on **23 April 2010**; this consultation is scheduled to last for 6 weeks. The workshop is intended to be a chance to work through and provide for group discussion, in particular from relevant licensees, of the proposed licence changes. If you would like to attend please confirm your interest by emailing: [industrycodes@ofgem.gov.uk](mailto:industrycodes@ofgem.gov.uk) by **12 April 2010**.

7.3. In late May 2010, the statutory consultation period on draft licence modifications will commence and we intend to publish Statutory Notice of the licence modifications in late June 2010.

7.4. In the event that licensees do not accept the licence modifications set out in the statutory consultation, we will need to consider whether to refer the matter to the Competition Commission.

### **Code of Practice/CAWG**

7.5. Ofgem intends to hold a workshop to discuss the detail of the Code of Practice on **29 April 2010** as part of the consultation process. Again, if you would like to attend please confirm your interest by emailing: [industrycodes@ofgem.gov.uk](mailto:industrycodes@ofgem.gov.uk) by **12 April 2010**.

7.6. Subject to this workshop and responses to the consultation we then intend to publish a final approved version of the Code of Practice in late May 2010. This will then provide the baseline on which we expect the licensees to make any necessary changes to the code rules to comply with the high level principles. We then expect the document to be developed by the Code Administrators over time.

### **Implementation**

7.7. As set out above, we anticipate relevant licensees will bring forward code modifications to align their rules with the principles of the Code of Practice and the requirements set out in the licence modifications. We expect that these modifications will go through the normal industry process and will not take effect until late summer/ autumn 2010 although we recognise that the timescales of modification processes are not entirely in the proposer's control.

### **Ofgem guidance on SCR process**

7.8. Ofgem intends that a guidance document on the SCR process will be published later this year to set out further detail on Ofgem's role and expected process that we intend to follow in initiating and carrying out an SCR.

## Appendices

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9	Role of Code Administrators – Final Impact Assessment	See associated document.
10	Governance of Charging Methodologies – Final Impact Assessment	See associated document.

## Appendix 1 - Consultation Responses








































### Summary of Responses

Responses received by Ofgem which were not marked as being confidential have been published on Ofgem's website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Copies of non-confidential responses are also available from Ofgem's library.

















































We have sought to address the key points raised by respondents within the main body of the document, in order to set them in context and aid understanding of our Final Proposals on each point. We have therefore not duplicated them here.

### List of Respondents

The following table sets out the respondents to the most recent consultation on each of the CGR work strands. Responses can be accessed by clicking on the relevant clipboard icon:

List	Name	<a href="#">Major Policy Reviews and Self Governance</a>	<a href="#">Role of Code Administrators</a>	<a href="#">Governance of Charging methodology</a>	<a href="#">Environment and Code Objectives</a>	<a href="#">Illustrative Drafting</a>
1	Association of Electricity Producers (AEP)					
2	Balancing and Settlement Code (BSC) Panel					
3	British Wind Energy Association (BWEA)					
4	Centrica					
5	Consumer Focus					
6	Connection and Use of Systems Agreement (CUSC) Panel					
7	Contract Natural Gas					
8	Drax					
9	E.on					
10	EdF					
11	Electralink					
12	Elxon					

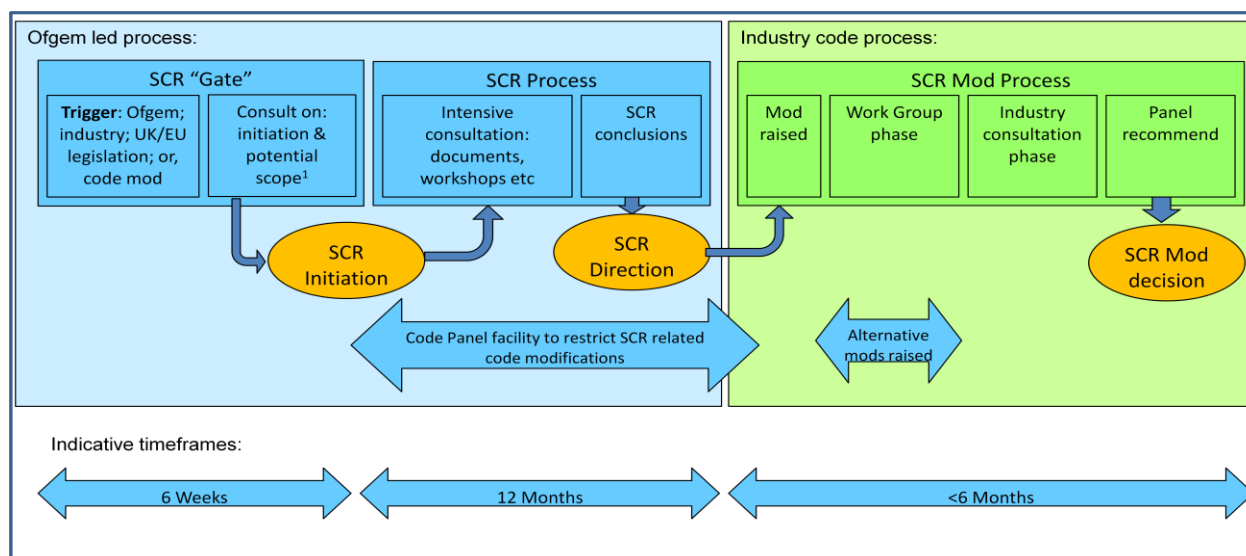


13	Energy Networks Association					
14	ESBI					
15	Gas Forum					
16	Good Energy					
17	Highlands and Islands Enterprise					
18	International Power					
19	Joint Office of Gas Transporters					
20	Master Registration Agreement (MRA)					
21	National Grid					
22	Northern Gas Networks					
23	Renewable Energy Association					
24	RWE npower					
25	Scottish Renewables					
26	Scottish Power					
27	Scottish and Southern Energy					
28	Statoil					
29	Uniform Network Code (UNC) Panel					
30	Wales and West Utilities					

## Appendix 2 – Significant Code Reviews

1.1. Following on from the high level principles set out in chapter 2, this appendix sets out our Final Proposals for the Significant Codes Reviews (SCR) in greater detail. The following diagram is intended to illustrate the process that a SCR modification proposal will follow.

**Figure 1: Overview of proposed Code Modification processes**



### The SCR process

#### Process before commencing an SCR

1.2. We consulted on the basis that Ofgem would have the sole right to decide to conduct an SCR and that we might do so where we identify a significant issue that bears on one or more industry codes, or in response to Government-led policy initiatives or changes emanating from European legislation, or in response to code modifications proposed by industry. We stated that we would give as much notice as possible of our intention to conduct an SCR and would, where possible, flag our intentions in our Corporate Plan. We said that we did not expect to conduct more than one or two SCRs per financial year.

#### Responses to initial proposals

1.3. Respondents were clear that they wanted as much notice as possible of SCRs and wanted industry input into the decision to launch an SCR. Some respondents said that the Government should also be involved in any decision to conduct an SCR. Many respondents expressed concern that our proposals lacked sufficient

detail. Some respondents acknowledged that there needed to be flexibility over the exact process that an SCR would follow but believed there should be some high level procedures common to all SCRs.

#### Ofgem's Final Proposal

1.4. We have created a standard template and process for SCRs. However, we propose that the application of the template may vary on a case-by-case basis according to the complexity or contentiousness of the issues at stake, to allow for flexibility. We will publish further guidance on the SCR process as part of a wider guidance document on our approach to handling industry code modifications and consider that this document would be kept under review, in the light of experience of the SCR process.

1.5. We acknowledge the desire for more detail on the process that we propose to follow in deciding whether or not to commence an SCR and on the process that we would follow while conducting an SCR and set out more details on the SCR process. We would emphasise that stakeholders will have several opportunities to influence not only our consideration of whether to conduct an SCR and the development of the conclusions that result from it but also the substance of any subsequent code modifications. We have also included flow charts at the end of this chapter setting out the proposed SCR process from beginning to end.

1.6. We propose that the following triggers might lead to the initiation of an SCR:

- developments in EU law or Government-led policy initiatives that have not otherwise been given full effect in legislation;
- a work stream internal to Ofgem;
- representations made by stakeholders (whether by code parties, code panels or other affected parties);
- code modifications proposed by the industry; or
- unforeseen circumstances that appear to Ofgem to require us to consider the case for significant reform of one or more industry codes.

1.7. Before taking the decision to launch an SCR we will consult stakeholders. Following such a consultation we may conclude that it is not appropriate to proceed with an SCR, for instance where greater priorities are identified or, notwithstanding the importance of the issue, there are potentially more appropriate methods of addressing the issues identified.

1.8. We propose that an SCR would relate to a matter which:

- could be given effect wholly or mainly through modification of the relevant industry codes; and
- the Authority considers to be of significance in relation to its principal objective and/or statutory duties and functions or obligations arising under EU law; and in particular:

- is likely to have significant impacts on gas and electricity consumers or on competition (this may be based on a qualitative assessment); and/or
- is likely to have significant impacts on the environment, sustainable development or security of supply;
- is likely to create significant cross-code or code-licence issues.

1.9. Whilst we consider that the majority of SCRs will originate with Ofgem, or some other source external to the industry codes, it is possible that a significant issue will first come to light through the modification process. Notwithstanding the origins of the issue, we consider that we should be able raise an issue to SCR status wherever it meets the characteristics listed above.

1.10. Where Ofgem considers that an SCR may be appropriate, we propose to consult on whether to initiate an SCR. We would invite interested parties to comment on the perceived need for an SCR, its scope and scale, and on whether an SCR would be the most effective means of addressing the issues concerned. We would also indicate the time and resources that might be required to pursue the SCR and invite views on the potential impact of conducting such an SCR.

1.11. We envisage that typically we would allow at least six weeks for interested parties to submit responses to an SCR scoping letter. Any decision by Ofgem as to timing would, however, take into account the perceived urgency of the need for the SCR. Consultation responses would of course be considered carefully by the Authority in reaching its decision on whether or not to proceed with an SCR.

1.12. As we stated in July 2009, we would seek to give as much prior notice as possible of our intention to undertake an SCR. For example, where reasonably possible we would aim to indicate in our annual Corporate Strategy document any intention to consult on potential SCRs in the forthcoming financial year. As part of our planning process, interested parties would be free to make representations that an issue should be dealt with through the SCR process.

1.13. If we decide to launch an SCR we will publish a statement:

- finalising the scope of the review;
- setting out clearly the reasons for conducting it as opposed to taking alternative courses of action, including maintaining the status quo (as against the criteria proposed above and our statutory duties);
- setting out our reasons for pursuing an SCR;
- considering responses to the scoping letter (non-confidential responses will be published on our website);
- assessing the impact of conducting the SCR, including the effect of restricting non-urgent code modifications (see below) and an estimation of the resource commitment required of Ofgem and the industry; and
- announcing the start date for the SCR, which may be the date on which this statement is published, and setting out a bespoke indicative timetable.

1.14. The SCR would broadly be conducted in line with the indicative timetable published in this statement. The precise duration of an SCR would vary according to the complexity of the issue concerned. However, we anticipate that the process from the initial consultation letter to the publishing of any directions would in most cases take no longer than 12 months.

1.15. We expect that an SCR would usually involve consultation on initial conclusions and publication of final conclusions. We would also undertake and consult on an initial and subsequently publish a final impact assessment on any proposals that we consider to be necessary. We would seek opportunities to supplement written consultations with stakeholder events such as workshops and roundtable conferences. We intend that there would be ample opportunity for stakeholders to influence the policy process before we reach any conclusions and issue any directions.

### **Dealing with modification proposals that relate to an SCR**

#### Responses to initial proposals

1.16. In our initial proposals we expressed the view that there should be no restriction on the right of parties to raise urgent modifications that relate to an SCR that Ofgem is undertaking. All those who commented agreed. We also proposed that non-urgent modifications that relate to an ongoing SCR should not follow existing code modification development processes but should be 'subsumed' within our SCR.

1.17. There were mixed views on this aspect of our proposals. Some felt that Ofgem should not in any way seek to restrict the right of a code party to propose a modification and to have that modification ultimately approved or rejected by Ofgem. On the other hand, a majority of those who commented broadly accepted that non-urgent modifications should be taken up by Ofgem as part of the Ofgem-led SCR process and should inform our conclusions. It was suggested that the panels should be consulted on any such decisions to 'subsume' a modification proposal.

#### Ofgem's Final Proposal

1.18. We propose that modification proposals raised between the period of Ofgem's initial scoping letter and any SCR launch statement would proceed according to the usual industry processes. However, we note that the Authority would not necessarily approve such modification proposals where they overlap with an imminent SCR and that such proposals would not necessarily prevent the SCR from being commenced. These decisions would be taken by the Authority on a case-by-case basis. Code parties and panels would be expected to take the potential SCR into account when evaluating the proposal against the relevant code objectives. A subsequent SCR would, of course, take account of any modification proposals that had been approved.

**Modifications raised once an SCR has commenced**

1.19. Without some kind of restriction on the scope for interested parties to raise relevant modifications there is a risk that the SCR process would become less efficient. However, we consider that urgent modifications relating to an SCR that has formally commenced should proceed and that existing processes for requesting and being granted urgency should apply. However, we would expect the proposer of any such urgent proposal to have regard to the timetable for any prevailing SCR when submitting any request for urgency. We are likely to agree that a proposal may follow an urgent timetable only if there is a relevant date-related event by when a decision should be made and failure to deal with the proposal urgently would have a significant commercial impact upon parties or on security of supply grounds. Parties should reasonably acknowledge that in pursuing urgent status, there is a risk that the proposal may not be consistent with the eventual conclusions of the SCR and that the proposal may not be implemented or may be superseded by new modifications.

1.20. Once an SCR has formally commenced, we propose that non-urgent modifications should not normally proceed along usual code development processes. Instead, we propose that Ofgem would normally consider the issues contained in them as part of the SCR. We consider that the restriction would appropriately end at the point we either state that no directions will be made to a licensee to raise a modification proposal or, if directions are issued, that date on which any such modification proposal is raised.

1.21. The illustrative licence drafting that we published last year anticipated that there might be times when Ofgem may wish to allow a non-urgent proposal to enter the normal process. This would enable Ofgem to act on a case-by-case basis, having regard to our duties and relevant code objectives, as well as to the proposer's or panel's representations. We have therefore retained this element of the proposed drafting in our Final Proposals.

1.22. We propose that code panels, with assistance from Code Administrators if appropriate, should assess (having regard to the representations made by the proposer or interested parties) whether a proposal falls within an SCR and whether it should continue through the modification process. The code modification procedures would need to be modified to facilitate wider code party involvement in this process. We envisage that a code panel, on receipt of a proposal, would assess its status and – unless otherwise permitted by the Authority – include this assessment in a written statement to Ofgem.

1.23. The panel's statement would also attach the actual proposal and any representations made by the proposer and/or any other interested parties. Ofgem would then give written notice within a defined period if it disagrees with the panel's assessment. We do not at this stage propose to prescribe the period by which we will provide notice, but do not anticipate that this would be longer than ten working days.

1.24. Where Ofgem considers that a proposal should be barred from the code modification process, the proposal would be considered by Ofgem as part of the SCR. Where Ofgem considers that the proposal should not be barred, the panel would accept it into the usual code modification procedures. Such a procedure could be similar to existing provisions in various codes to enable the Authority to give a view on whether a modification should proceed.

### **Modifications proposed after SCR Directions have been issued**

1.25. In December 2008, we sought views on whether, in order to maximise the efficiency benefits of SCRs, there should be a two year moratorium on modification proposals that related to issues covered in an SCR. Respondents to the December 2008 consultation were opposed on the basis that this might prevent improvements being made to a recently introduced framework, perhaps in the light of new information.

1.26. In July 2009, we acknowledged this argument and proposed instead a time window in which parties could raise alternatives to the modification proposal raised by the relevant licensees in response to an SCR Direction. We suggested that the time window could be a period of two months “from the Authority’s completion” of an SCR and proposed to seek a power to “turn down consideration of alternative proposals raised within the time window if they are insufficiently developed”.

### Responses to initial proposals

1.27. Respondents welcomed our decision not to pursue a two year moratorium but were divided on whether the time window proposal was desirable or practical. Some respondents felt that the two months suggested would be insufficient. One respondent stated that the time window should start when the licensee has raised its own modification rather than at the date of the SCR Direction itself, since this would give parties a proper chance to consider whether there was a better alternative to the original SCR modification (which might be raised at the end of the time set out in the SCR Direction). While some supported the idea of Ofgem being able to veto insufficiently developed alternative modification proposals, several parties did not. It was pointed out that we could instead use our proposed ‘call in’ and ‘send back’ powers (as described in chapter 3). Others sought clarity on what would be meant by “insufficiently developed”.

### Ofgem's Final Proposal

1.28. Once Ofgem has issued a direction requiring a licensee to raise a modification, there is nothing to prevent the directed licensee from liaising with another code party in developing the SCR-related code modification proposal and nothing to prevent other code parties starting to prepare in anticipation of that modification proposal.

1.29. In order to maximise the efficiency of the process, we consider that it should not be possible to raise non-urgent code modification proposals until the SCR proposal is raised by the directed licensee. At that point we propose that code parties should be able to raise alternative modifications. This would give other code parties a clear minimum period of opportunity to review the proposal and if appropriate submit their own alternative. This would be especially important if the direction is at a relatively high level, requiring a reasonable, and varying, degree of post-direction development.

1.30. The Code Administrators Working Group (CAWG) has recommended that alternative modification proposals should only be raised during the workgroup phase of the modification process. CAWG considered that there should be normal time periods for these different stages subject to extension by Ofgem. We propose to implement the CAWG recommendations.

1.31. We propose that alternatives relating to an SCR modification proposal that are raised after the workgroup phase may proceed at Ofgem's discretion. If the proposal is raised late in the process and contains very little detail or otherwise requires significant development, we may conclude that it is inappropriate to hold up the development of the SCR modification proposal any longer.

1.32. It is also possible that a further proposal on the same area as an SCR may be raised once the original is with Ofgem for a decision. Ofgem would not necessarily deal with the modifications simultaneously or delay the decision in relation to an earlier SCR-related modification proposal. Ofgem would make such procedural decisions on a case-by-case basis. Code parties and panels would need to take into account the risks associated with the timing of any proposal of this kind.

### **Outcome of an SCR**

1.33. In our initial proposals we noted that the SCR process would lead to Ofgem publishing its policy conclusions and that this publication would, if appropriate, set out the arrangements that would need to be reflected in the codes (and possibly in other documents). We consulted on the basis that Ofgem would seek to modify network licences to require them to comply with any future direction by the Authority relating to SCRs.

### Responses to initial proposals

1.34. Some respondents supported the proposal. Several disagreed on the basis that Ofgem should not be able to direct any party in this way given that the Authority would ultimately decide whether or not to approve SCR-related modification proposals. It was noted that Ofgem could be perceived as acting as judge and jury in such a process and that its impartiality in evaluating modification proposals would be called into doubt. Others stated that Ofgem should, if proceeding with its proposals, seek to modify the licences of all code signatories since they too would be affected by the proposals.



### Ofgem's Final Proposal

1.35. Following consultation on final conclusions, Ofgem will publish SCR Conclusions on the issues and any actions that are in our view necessary. This document may be accompanied, or followed shortly, thereafter by SCR Directions to the relevant licensee to develop and submit to the relevant body one or more modification proposals in accordance with a timetable specified by Ofgem.

1.36. We propose that the relevant licence holder should have an obligation to raise and facilitate consultation on modifications that give practical effect to any SCR-related directions issued by the Authority. We propose that this obligation would be generic in form and should be introduced through a licence modification. Relevant licensees would be obliged within a specified period of time, via a direction issued by the Authority, to develop and consult on modifications that give practical effect to the matters set out in the SCR related direction. We propose that the relevant licensee would not be permitted to withdraw its modification proposal without the consent of the Authority.

1.37. As recognised in our proposals on alternative proposals, we consider there is still a degree of flexibility for development of the proposal following a Direction through alternative modifications. We would welcome alternatives to the extent that they also seek to address the conclusions of the SCR. Whilst we would not fetter the discretion of the Authority in relation to any such modification proposals, we envisage that we will actively participate in any development groups and provide any necessary further clarity on our thinking.

1.38. As stated above, we propose to implement SCRs and self-governance in the BSC, CUSC and UNC in the first instance. We therefore propose to modify the electricity transmission and gas transporter licences so that National Grid and the GDN gas transporter licensees are obliged to comply with any SCR-related directions. However, we recognise that there may need to be consequential changes to other codes. We consider that these should be reasonably accommodated in a similar manner as existing changes which impact upon related codes.

1.39. We note that in some instances a change to the industry codes may also prompt a change to the underlying charging regime. Our proposal (see chapter 4) to subsume the charging methodologies within the governance of the relevant industry code will provide for a more holistic approach to such changes and ensure that they can be considered as part of the same process. In the instance that the charging methodology was contained other than in the relevant industry code we consider that that document may appropriately be considered as a related document for the purposes of consequential change provisions, depending on the circumstances at the time and the particular interaction between the subject of the SCR and the applicable charging methodology objectives.

1.40. Although the relevant licensee would be required to draft and consult on a modification, the proposal would then proceed through the usual industry

consultation processes. Code parties (including the licensee subject to the direction) would be entirely free to propose alternative modifications and vote at panel meetings in accordance with a code's relevant objectives.

1.41. We set out in July 2009 the reasons why we did not believe that Ofgem would be acting as "judge and jury". We noted that Ofgem would retain an open mind throughout the process and that the Authority would ultimately make decisions on modification proposals according to its statutory duties. This remains our view.

1.42. We also note that if the SCR Directions were not binding, this would in all likelihood frustrate the intention underpinning SCRs, which is to ensure that a holistic Ofgem-led review process leads to the timely development of and consultation on code modifications that enable the industry to meet the challenges facing it - including those of climate change and security of supply.

1.43. We propose that the time period specified for the development of the modification proposal(s) should be assessed on a case-by-case basis (having regard to industry feedback) and that the Authority should have the discretion to vary the time period according to the number and complexity of modification proposals that need to be produced. It is likely however that the deadline will be in the range of one to four weeks.

### **Drafting of SCR-related code modifications**

1.44. We stated that our preferred position was for licensees to draft SCR-related code modifications rather than for Ofgem to do so and put forward two options. Under option 1, Ofgem would carry out the review and develop high level policy conclusions. Ofgem would issue a direction to relevant licence holders to raise a modification proposal(s) that would deliver the conclusions of the review. Under option 2, Ofgem would carry out the review and develop detailed conclusions that could take the form of an outline of a code modification proposal. This option would involve Ofgem defining the parameters of any new arrangements in much more detail than option 1 and the code panel/relevant licence holder(s) would be required to develop a modification proposal based on the binding outline.

1.45. We also proposed a backstop power for Ofgem to draft code modifications legal text in the event that a licensee failed to produce a modification proposal that was consistent with our Direction.

### **Responses to initial proposals**

1.46. Most respondents who commented agreed with our preferred position that licensees should draft SCR-related code modifications rather than Ofgem itself. One suggested that even if industry drafted the modification it would be vital for Ofgem to be engaged in the process. Some respondents disagreed on the basis

that there should be no compulsion of any sort on code parties to raise modifications.

1.47. Opinion was on balance against the proposal that Ofgem could have a 'backstop' power to draft code modifications legal text in the event that a licensee failed to produce a modification proposal that was consistent with our Direction or failed to do so within the specified time period.

1.48. Several respondents were strongly opposed to the backstop power, mainly on grounds of potential for actual or perceived procedural unfairness (the 'judge, jury and executioner' critique), which could run counter to better regulation principles. Some of these respondents suggested that if this power were to be pursued, there ought to be an internal separation of Ofgem staff drafting the modification from those involved with the final decision. However, there was some comment to the effect that it would be in keeping with the origin of a proposal if Ofgem were to draft SCR modifications. Some respondents wanted more guidance on when such a power could be used. One observed that the power should not be needed and if it were then the SCR conclusions or directions were probably flawed. National Grid felt that Ofgem should instead clarify any drafting problems with the relevant licensee.

#### Ofgem's Final Proposal

1.49. Taking account of the views expressed, Ofgem proposes that the industry should take the lead in drafting and developing SCR-related code modifications. We do not intend to seek powers to draft legal text for code modifications. However, we note again that, in its conclusion on the UNC116 appeal, the Competition Commission stated that natural justice would not be offended if we were the "effective progenitor" of modifications, provided that "where GEMA is giving or refusing its consent to such proposals, its better regulation duties of transparency and accountability apply with particular rigour".

1.50. In the first instance, we would of course intend that any directions are expressed as clearly as possible to minimise the risk of misinterpretation and to a level of detail that we consider appropriate in the circumstances. We would expect the relevant licensee to engage with us promptly if there is any matter which is not clear. As noted in chapter 3, we are proposing 'send back' powers in relation to the role of Code Administrators, which would enable Ofgem to revert to the relevant code panel if we consider that the final modification report is in some way deficient and preventing the Authority from making a decision. Although this would primarily relate to situations where we do not consider the analysis to be sufficiently robust, we consider that it could equally apply to situations where we consider that the legal text is not fit for purpose. Ultimately, if we consider that the licensee has not fully discharged the direction given to them, it may be a matter for enforcement action.

1.51. On that basis we propose to take forward option 1 and option 2, which involve Ofgem setting down the principles that should inform any code

modification proposal and perhaps outlining the code modification proposal itself. Ofgem would assess on a case-by-case basis whether to set out high level or detailed principles only. Whilst in some cases it may be appropriate to include an outline code modification, we will not expect to provide complete legal drafting and have not carried forward our proposed powers to do so.

### **Power to modify a Direction**

1.52. In the initial proposals we suggested that Ofgem should be able, where necessary, to revise its SCR conclusions and issue new SCR Directions, for instance if new information came to light or in the event that we were required to amend the SCR Direction following a successful appeal.

#### Responses to initial proposals

1.53. Whilst many respondents saw this as a pragmatic suggestion, there was also opposition on the grounds that it would create uncertainty and increase risk. These respondents noted an absence of detail about how this would work and asked whether we would consult on our new findings. Others argued that we should not have this ability if parties did not likewise have the ability to raise new modifications in response to new information. Two respondents argued that if parties were allowed to raise new modifications then Ofgem would not need to change SCR Directions. All respondents requested further detail on how it might work. There was, however, a small majority of respondents who considered that Ofgem should be able, where necessary, to revise its policy or reconsider its SCR conclusions and issue new SCR Directions as policy detail develops or if new information comes to light.

#### Ofgem's Final Proposal

1.54. We acknowledge concerns voiced by respondents about regulatory uncertainty, though we note that there are existing provisions, for instance under the Electricity Act 1989<sup>13</sup>, that allow for Directions to be varied or revoked. We do not propose to change such existing powers in the context of SCRs. We consider that the existing processes and our existing powers can adequately address the issue of responding to new information.

1.55. We note that if new information came to light after the SCR Direction, or events dictated that the SCR modification was no longer appropriate, then the Authority may revoke its direction or the proposal itself could be varied or

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13 Electricity Act 1989, Sections 107 'Directions':

(1) It shall be the duty of any person to whom a direction is given under this Act to give effect to that direction.

(2) Any power conferred by this Act to give a direction shall, unless the context otherwise requires, include power to vary or revoke the direction.

(3) Any direction given under this Act shall be in writing.

ultimately rejected by the Authority. We do not therefore propose to pursue a new, SCR-specific power to modify SCR Directions. However, we propose to amend the licence to ensure that a modification proposal raised in compliance with a SCR Direction may not be withdrawn without the Authority's prior consent. In addition, Ofgem fully intends to liaise with industry throughout the code modification process (for example by attending working group meetings) and will participate in any discussions about the impact of new information on an SCR Direction or modification.

### **SCR-related modification decisions and afterwards**

#### Responses to initial proposals

1.56. We proposed, if there were a time window for alternative modifications, that no further non-urgent modifications should be allowed in the period between the Authority making a decision of an SCR-related modification and its implementation. Finally, we proposed that if an SCR-related modification decision were appealed to the Competition Commission, no new but related modifications should be raised for the duration of the appeal process. There was little comment on these proposals.

#### Ofgem's Final Proposal

1.57. Once a panel has submitted its SCR-related modification report to Ofgem, we will aim to make decisions on SCR-related modifications within 25 working days in accordance with our existing performance indicator.

1.58. When taking decisions on SCR-related modification proposals, the Authority would take fully into account submissions made either during or after the SCR regarding the perceived need for a code modification or the form of the modification proposed. The Authority would also consider any panel recommendation and the reasons underpinning it along with any new information that had been presented to Ofgem and any other matters that were relevant in the circumstances.

1.59. We propose that all modifications should be allowed once a decision on the directed licensee's SCR-related modification proposal has been made. We note that, if a decision on the directed licensee's SCR-related modification proposal has been appealed to the Competition Commission, the Authority will take this fact into account in determining its position on any subsequent related modification proposal.

## Appeal rights

### Responses to initial proposals

1.60. In July 2009, we proposed that there did not need to be any new appeal rights associated with the SCR process. In making that case, we sought to demonstrate that our proposals would not affect existing rights of appeal. In particular, we made it clear that while a licensee might be directed to raise and develop a modification, it would not be required to recommend and vote for it at panel meetings. Respondents welcomed this clarification though one party called for declarations by panel members to the effect that they could vote freely and argued that network and independent chairs should be required to abstain in panel votes on SCR-related modifications.

1.61. We also sought to allay fears that “binding” SCR conclusions would hamper the ability of the Competition Commission to fulfil its statutory role in hearing code modification appeals. We noted that the Competition Commission did not anticipate that our proposals would have this effect. Several respondents indicated that they welcomed the Competition Commission's views and on that basis agreed that existing appeal rights were sufficient. Two parties noted the Competition Commission's view but wanted a fuller explanation of it.

1.62. While noting our efforts to clarify the position, several respondents nonetheless believed that further appeal rights were needed, particularly when we publish SCR conclusions and issue any subsequent directions. They stated that it would be inefficient to delay an appeal until after a modification had been developed. One respondent advocated the introduction of ‘blocking minorities’ in relation to SCR Directions similar to those in relation to proposed collective licence modifications<sup>14</sup>.

1.63. Several respondents suggested that all SCR related code modification decisions should be appealable to the Competition Commission irrespective of whether the Authority is concurring with a panel’s recommendation. Some linked the issue of appeals to the proposal that the Authority appoint the panel chair, which was felt to unduly influence it. One respondent stated that the nature of the SCR process required that there was an individual company right of appeal on grounds of undue prejudice or material hardship in order to comply with EU law. Another also suggested that concerns about insufficient appeal rights were heightened where Ofgem used back stop powers to draft its own modifications.

### Ofgem’s Final Proposal

1.64. We continue to hold the view that there is no need to introduce a Competition Commission appeal at the SCR conclusion and Direction stages. The

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<sup>14</sup> If 20% or more of relevant licensees (measured by number of licensees or market share) formally object to a collective licence modification proposal, the modification may not be made. Ofgem may however then choose to refer the matter to the Competition Commission.

appeals mechanism is provided for in primary legislation and is therefore not within our gift to amend. However, we have taken measures to provide parties with a greater degree of comfort on the way in which appeals could be sought. We also note that, whilst we remain of the view that panel chairs should be independent, we no longer consider that they must be appointed by the Authority.

1.65. To the extent that parties believe that further checks and balances are needed in relation to SCR modification proposals, it may be possible to pursue them through changes to the modification rules. For instance, while panel recommendations are currently made on the basis of a simple majority, the rules could be changed to require a different threshold for SCR modification proposals. We have ourselves considered the case for introducing a different threshold for SCR modification proposals but do not believe that there is a compelling case for doing so at this time. However, we note that parties can bring forward proposals and we would of course consider them on their merits.

## Appendix 3 – Self-governance

1.1. This appendix sets out our view on the detailed process points that may be associated with a self governance process. As set out in Chapter 2, we consider that it is for the parties of the relevant codes to raise appropriate code modification proposals in order to give effect to our proposals for self-governance.

### **The filtering decision and Ofgem’s veto**

1.2. In our initial proposals we sought views on whether code panels should decide which pathway a non-SCR modification proposal should follow, subject to an Ofgem veto. The basis for this decision would be the self-governance criteria discussed below, which is a means of determining the materiality of the proposal. We also consulted on the suggestion that these panel filtering decisions could be overturned by Ofgem at any point during the industry process.

#### Responses to initial proposals

1.3. Most respondents agreed that code panels should make the decision. It was also suggested that the proposer should be required to suggest which pathway should be followed. Respondents generally acknowledged that Ofgem should have the power to override a filtering decision if it subsequently became clear that a self-governance proposal is likely to have non-trivial impacts. However, several stated that the veto should be strictly time-limited (perhaps within five days of a panel’s filtering decision) so as to avoid late redirections that would be inefficient for the industry. Some suggested that the panel should also be able to revisit filtering decisions.

#### Ofgem’s Final Proposal

1.4. We propose that panels should be able to choose between paths 2 and 3. We agree that, in order to inform the panel’s decision, modification proposers and other interested parties should be required to indicate the pathway that they believe a proposal should follow and the reasons why the panel should consider this to be appropriate. However, the filtering decision will remain that of the panel. We propose that, if a code panel considers that a modification proposal meets the criteria for self-governance and can enter the self-governance process, it should be required to make a statement to Ofgem to that effect. We also propose that Ofgem should have the power to override panel filtering decisions.

1.5. While acknowledging the industry’s concern about late redirection of modification proposals, we consider that the ability to overturn filtering decisions should extend beyond the early stages of the modification process. This is because new information, particularly from consultation respondents, may come to light only at a later stage. We consider that this approach would be consistent with the recently revised SPAA change procedures.



**Filtering criteria**

1.6. In our initial proposal, we proposed that modification proposals should enter self-governance processes if in the view of the relevant code panel they would have a trivial impact on matters relevant to our principal objective or other statutory duties. On that basis we had suggested that as many as 50% of code modification proposals could be suitable for the self-governance process.

**Response to initial proposals**

1.7. Most respondents agreed that the proposed criteria were sensible. Some respondents called for further detailed guidance but the majority felt it was unnecessary and that it was better to retain flexibility and allow the panels to be pragmatic.

**Ofgem's Final Proposal**

1.8. We propose that a code modification proposal should only be implemented without the Authority's approval where, in the view of the panel, the modification proposal if implemented would have non-material impacts upon specified matters including consumers, competition, security of supply or sustainable development.

1.9. We propose that the code panel, perhaps assisted by the Code Administrator, should be required to submit a statement to Ofgem to the effect that a particular modification proposal, in its view, is unlikely to have material impacts on the specified matters and therefore should follow a self-governance process. We propose that Ofgem should then have up to 28 days to give notice if it disagrees. We further propose that the modification procedures must provide for consultation and evaluation on the availability of the self-governance route for each modification proposal.

1.10. Our suggestion that around 50% of all proposals could follow this path was based on a retrospective assessment of the proposals put to us in a recent 12 month period. (This did not include proposals dealt with under existing self-governance mechanisms.) We consider that there is considerable merit in the self-governance process even if the number of modifications that go through this route are lower than set out in our impact assessment. However, in the light of responses we have reconsidered the filtering criteria and now propose modifications which are likely to have non-material impacts should proceed through self-governance processes.

**Panel and voting arrangements**

1.11. We consulted on the basis that the industry should draw up proposals for panels and voting arrangements.

### Response to initial proposals

1.12. The majority of respondents supported our proposal that industry parties should draw up proposals for panels and voting arrangements and submit them to Ofgem as part of a self-governance package. Some suggested that we should provide more guidance, for instance a straw man of minimum requirements. Consumer Focus stated that we should use the currently constituted panels. Consumer Focus also noted that it would, if necessary, apply to Ofgem to redirect a modification to Path 2 (i.e. from self governance to the usual modification route). The Code Administrators generally championed their own existing arrangements. Concern was expressed by one respondent that as Ofgem was content to rely on code parties raising their own modification proposals for introducing self-governance processes, this could be seen as a lack of commitment to self-governance.

### Ofgem's Final Proposal

1.13. Ofgem regards the development of arrangements for industry self-governance as an integral part of the codes governance reform package. It is in the spirit of promoting self-governance that we invite the industry to develop their own proposals on panel and voting arrangements and submit them to us for consideration.

### Appeals

1.14. We consulted on the basis of all parties, including consumer groups having equal appeal rights on self-governance code modification decisions. We also proposed that Ofgem would hear appeals but that an interim forum could be a useful device for industry to resolve disputes without recourse to Ofgem.

### Response to initial proposals

1.15. Respondents agreed that all parties, including consumer groups, should enjoy the same rights of appeal in relation to self-governance modification proposals. Respondents also generally supported our proposal that appeals should be possible on the grounds that a modification would not better facilitate the applicable code objective(s), result in "unfair prejudice" and/or cause a party to be in breach of an agreement.

1.16. Whilst all respondents agreed that Ofgem should hear appeals, opinion was mixed about the value of an interim forum. Some considered that it would add complexity, delay and costs while being unlikely to resolve disputes. The majority of respondents agreed that Ofgem should be able to decline to hear an appeal if it considers the case to be frivolous, vexatious or to have no reasonable prospect of success, although a couple wanted more guidance on what might be considered frivolous. One party objected to the "no reasonable chance of success" test on the basis that that would be to prejudice the outcome. Another welcomed the

possibility of recourse to the Competition Commission in the event that Ofgem accepted or rejected a self-governance modification that had been appealed to it.

#### Ofgem's Final Proposal

1.17. We propose that the appeals regime for self-governance code modification decisions should largely be on the basis set out at initial proposals. We propose that:

- all parties should enjoy equal rights of appeal;
- Ofgem should hear appeals;
- the grounds for appeal should be that
  - the appealing party would be unfairly prejudiced by the outcome of the self governance determination, or
  - the implementation, or as the case may be rejection, of the proposal does not better facilitate the applicable code objective(s); and
- Ofgem should be able to decline to hear an appeal if it considers the case to be frivolous, vexatious or to have no reasonable prospect of success.

1.18. We consider that a party could reasonably argue that its interests would be unfairly prejudiced if the implementation of a modification proposal could cause it to be in breach of its licence, the relevant code or any other legally binding agreement. We therefore do not consider it is necessary to separately list this issue of breach as separate grounds for appeal.

1.19. We propose that, on appeal, it should be open to Ofgem to quash the panel's decision; refer the matter back to the panel for reconsideration (following which the panel could take the same decision again or take a different decision); quash the decision and take the decision; or affirm the panel decision/hold the appeal unsuccessful. We would expect these arrangements to be reflected in the modification rules of each code and therefore look forward to working with the industry on the development of suitable modification proposals.

1.20. We note that the Competition Commission can already decline to hear appeals in relation to the Authority's code modification decisions on the grounds proposed above. The Competition Commission has not published guidance in this area and we do not consider it necessary for Ofgem to do so. We remain of the view that an interim forum could be a useful device to limit the number of appeals to Ofgem. However, we believe it is for industry parties to raise proposals if they consider that a forum will be useful.

## Appendix 4 - Guidance on the treatment of carbon costs under the current industry code objectives

### 1. Introduction

- 1.1 The clarification and guidance contained in this document relate to the following codes: the Balancing and Settlement Code, the Connection and Use of System Code, the Uniform Network Code, the Distribution Connection and Use of System Agreement, the System Operator Transmission Owner Code, the Uniform Network Code for Independent Gas Transporters, the Grid Code and the Distribution Code.
- 1.2 These codes govern many aspects of the electricity and gas markets arrangements. It is a feature of all of these codes that they are capable of being modified in accordance with industry led modification procedures. Under these modification procedures code panels and/or other industry parties need to assess proposed modifications against certain objectives. While the precise objectives vary from code to code, they all contain an objective relating, broadly, to the efficient and economic operation of the relevant network system.
- 1.3 This document sets out our position on the scope for considering carbon costs within the existing code governance framework. It also contains some guidance to code panels, administrators and industry participants as to how they could take account of this clarification in practice.

### 2. Relevant, recent developments

- 2.1 The introduction of policy instruments such as the EU Emissions Trading Scheme (ETS) in 2005 has meant that a market value can be placed on the cost of greenhouse gas emissions including carbon dioxide. In addition, the Government has issued updated guidance on valuing carbon which can also be used to assess environmental costs and benefits.<sup>15</sup> The revised approach to carbon valuation is intended to determine the estimated abatement costs that need to be incurred to meet specific emissions reduction targets.
- 2.2 These developments mean that it is possible to place a quantifiable value on carbon dioxide and other greenhouse gas emissions and that this value can be used when assessing the impact on these emissions of proposed code modifications.

### 3. Significance of developments within existing code arrangements

- 3.1 We consider that it is possible to take account of these environmental costs and benefits, in the same way that we (and the code panels and industry)

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<sup>15</sup> The guidance, entitled 'Carbon Valuation in UK Policy Appraisal: A Revised Approach' (dated July 2009), has been issued by DECC and is available at: [http://www.decc.gov.uk/en/content/cms/what\\_we\\_do/lc\\_uk/valuation/valuation.aspx](http://www.decc.gov.uk/en/content/cms/what_we_do/lc_uk/valuation/valuation.aspx)

would consider other economic costs and benefits, when assessing a modification proposal against the relevant code objective governing efficient and economic network operation.

- 3.2 In view of this, we would expect that such costs and benefits should be taken into account (where relevant) by the code panels and industry participants when assessing a modification proposal against the relevant code objective governing efficient and economic network operation.
- 3.3 In practical terms, therefore, we expect that industry and/or code panels (as appropriate) should take the following steps:
- (a) When assessing a modification proposal against the relevant code objective governing efficient and economic network operation, if the relevant industry participant and/or code panel consider that the impact of a modification will or may be to reduce or increase greenhouse gas emissions (and that this impact is likely to be material) then, to the extent that this impact will or might affect their assessment of the modification against the code objectives, the quantifiable environmental costs and benefits associated with the greenhouse gas emissions should be assessed (using the methods described in paragraph 3.4). The likely level of impact (materiality) will no doubt influence how the industry participant and/or the code panel go about this assessment. They may, for example, consider it appropriate to make enquiries of the relevant network operator. In addition, or alternatively, the relevant industry participant and/or code panel may decide it would be appropriate to employ the relevant expertise to undertake such assessment.
  - (b) Where they have evaluated the environmental costs and benefits of greenhouse gas emissions, the relevant industry participant and/or code panel should use the results of this analysis to inform its assessment of the relevant modification against the efficient and economic network operation objective of the relevant industry codes.
- 3.4 Where an industry participant and/or code panel undertake an assessment of greenhouse gas emissions, the relevant industry participant and/or code panel undertaking the analysis should, where that assessment is of a level that would warrant it:
- (a) quantify the impact on carbon dioxide and/or other greenhouse gas emissions in terms of tonnes of carbon dioxide using the updated guidance provided by DECC. The guidance includes greenhouse gas global warming potentials which can be used to convert emissions of other greenhouse gases into tonnes of carbon dioxide equivalent in order to value these emissions using a 'non-traded price of carbon'<sup>16</sup>. Emissions of other greenhouse gases should, where relevant, include any effects on methane leakage from the gas transmission and

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<sup>16</sup> The DECC guidance (see footnote 1) provides details regarding conversion.

distribution systems and sulphur hexafluoride leakage from electricity transmission and distribution;

- (b) develop a range of cost scenarios for changes (increases or decreases) in emissions in sectors covered by the EU ETS generally valued at the 'traded price of carbon' and changes in emissions for sectors not covered by the EU ETS generally valued at a 'non-traded price of carbon'. Values for both are set out in the updated guidance<sup>17</sup>. We recognise that going forward, other mechanisms to measure the commercial costs of greenhouse gases may be developed and this clarification and guidance should not be interpreted as precluding the use of any such mechanisms; and
- (c) include scenarios using both a social discount rate and a commercial discount rate. In calculating the social discount rate, the relevant industry code participant and/or code panels should have regard to the guidance in the Treasury Green Book.<sup>18</sup>

#### **4. Other considerations**

- 4.1 Ofgem notes that there are potentially wider impacts on the environment beyond the cost of greenhouse gas emissions that may need to be assessed by code panels based on *existing licence obligations* (for example, in the case of CUSC modification proposals, panels would need to consider, where relevant, the extent to which a proposal impacts on the discharge of National Grid's duties relating to the environment under Schedule 9 of the Electricity Act). This document does not offer guidance on these assessments or the interpretation of the Schedule 9 duties.

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<sup>17</sup> Page 119 of the guidance.

<sup>18</sup> [http://www.hm-treasury.gov.uk/data\\_greenbook\\_index.htm](http://www.hm-treasury.gov.uk/data_greenbook_index.htm)

## Appendix 5 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in UK statute (such as the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004 and 2008) as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.<sup>19</sup>

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly<sup>20</sup>.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity inter-connectors.

1.5. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>21</sup>;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.<sup>22</sup>

19 Entitled “Gas Supply” and “Electricity Supply” respectively.

20 However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

21 Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

22 The Authority may have regard to other descriptions of consumers.

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed<sup>23</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out these functions the Authority must also have regard to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>24</sup> and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

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<sup>23</sup> Or persons authorised by exemptions to carry on any activity.

<sup>24</sup> Council Regulation (EC) 1/2003.



## Appendix 6 - Glossary

### B

#### BSC

Balancing and Settlement Code.

### C

#### CCM

Connection Charging Methodology.

#### Cash-out

Under the Balancing and Settlement Code when parties are not in balance with their contracted positions then the amount paid is calculated as follows:

Short Market Not enough Electricity	Long Market Too much Electricity
System Buy Price = Main Price	System Sell Price = Main Price
System Sell Price = Reverse Price	System Buy Price = Reverse Price

The Reverse Price is derived from short term energy trading information from the forwards and spots markets and is calculated by APX Group.

#### Charging Methodologies

The way in which charges are calculated.

#### CA

Code Administrator.

#### CAWG

Code Administrators' Working Group.

#### Code of Practice

Document setting out the: (i) principles to which modification rules should adhere; (ii) requirements on Code Administrators to act as 'critical friends'; and, (iii) templates for key stages in the modification processes.

### Critical friend

Role of Code Administrators to play 'devil's advocate' and provide assistance to parties/consumer representatives.

### CUSC

Connection & Use of System Code.

## D

### DCMF

Distribution Charging Methodology Forum.

### DCUSA

Distribution Connection & Use of System Agreement.

## G

### GHG emissions

Green house gas emissions. A collection of gases which absorb infrared radiation and trap its heat in the atmosphere.

### GDN

Gas Distribution Network.

## I

### iGT UNC

Independent Gas Transporters' Uniform Network Code.

### Industry Codes

Contractual arrangements containing commercial and technical obligations/rules governing Great Britain's gas and electricity sectors.

## K

### KPI

Key Performance Indicator. A scorecard to assess whether duties are being met.

**L**[Licence](#)

Document issued by Ofgem permitting a named entity to carry out restricted activities.

**N**[NWO](#)

Network Operator.

**S**[SCR](#)

Significant Code Review.

[SCR Direction](#)

Where Ofgem requires a licensee to raise a modification proposal to implement the conclusions of a Significant Code Review.

[SPC](#)

Shadow Price of Carbon.

[STC](#)

System Operator – Transmission Owner Code.

[Security of Supply](#)

Ensuring that reasonable energy consumption demands are met.

**T**[Transmission Access](#)

Ability to connect to the transmission system.

[TCMF](#)

Transmission Charging Methodology Forum.

**U**[UNC](#)

Uniform Network Code.

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## Appendix 7 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

- Does the report adequately reflect your views? If not, why not?
- Does the report offer a clear explanation as to why not all the views offered had been taken forward?
- Did the report offer a clear explanation and justification for the decision? If not, how could this information have been better presented?
- Do you have any comments about the overall tone and content of the report?
- Was the report easy to read and understand, could it have been better written?
- Please add any further comments?

1.2. Please send your comments to:

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