DTI consultation on improving the transparency and accountability of Code Modifications

Ofgem's Response

June 2003

Executive Summary

The Current Position

The industry Codes form a major part of the framework of the gas and electricity industries. These regimes are widely viewed as models of flexible governance, particularly in contrast to the electricity Pool, whose governance was "widely recognised as inadequate and cumbersome" (NAO, 2003). Current arrangements enable the Codes to be changed, in a timely way, in the light of operational experience and industry developments. The ability to respond quickly to changes is particularly important where security of supply is concerned. Seen against these objectives the current arrangements have been highly successful.

Moreover the current arrangements already involve a high level of transparency and accountability. Only industry and consumer representatives can propose modifications. The Panel or network transporter makes a recommendation following industry consultation. The Authority makes a final decision, taking into account the applicable Code objectives and its wider statutory duties; the Panel or network transporter's recommendation and other views expressed in the consultations. The decision letter addresses all the main issues and explains the reasoning in detail. There is an existing route of appeal through judicial review, and parties have already made use of that route. Moreover, Ofgem[1] has committed to produce Regulatory Impact Assessments for all major new policy decisions.

Extension of Appeal Process

The DTI consultation makes it clear that to justify taking action "there must be clear and convincing evidence that the current process is not functioning as it could do". Ofgem's view is that the need for change has not been demonstrated.

On the specific question of whether to introduce a further right of appeal on Code modifications Ofgem's view is that this would introduce unacceptable delay and cost into the process, given the nature of the decisions involved. About 200 modifications are proposed each year to the industry Codes, which each have around 150 signatories.

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[1] Ofgem is the office of the Gas and Electricity Markets Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this document.

In a large proportion of cases there will be winners and losers and companies would therefore have a commercial interest in appealing – even if only for tactical reasons (particularly if the lodging of an appeal delayed implementation of commercially unwelcome changes).

Many of the modifications involve matters of great technical complexity. Coming to a well-reasoned decision would therefore require considerable time and resources from the appellate body, and would impose correspondingly high costs on parties, industry and consumers. On a conservative estimate the direct costs of introducing an appeals mechanism would be around £20m p.a. Perhaps the greatest cost however would lie in the increased regulatory uncertainty arising from the potential for lengthy appeals.

While the consultation proposes a number of options for limiting the number of appeals and addressing the need for urgent decisions to be excluded, there are real problems with finding solutions that would be robust and that would not create perverse incentives. Ofgem is sceptical as to the likelihood of finding acceptable solutions to these problems, either in theory or practice.

There are a number of other aspects of an appeals mechanism – such as whether to stop the clock on implementation while an appeal is heard – where it is not clear that a workable solution can be found. The introduction of an appeals mechanism therefore risks prejudicing the effective operation of the wholesale energy market.

It is essential that the benefits of any change clearly outweigh the costs. In Ofgem's view this would not be the case with the introduction of a formal appeal mechanism.

Alternative Approaches

Aside from appeals, the consultation proposes a range of other possible changes which would seem to offer a more proportionate approach, should DTI conclude from this consultation that there is clear and convincing evidence of the need for change.

In particular, the DTI proposed a number of ways of improving the ability of companies to influence decisions ex-ante. This would involve Ofgem:

1. producing a "minded to" decision where it intended to deviate from the Panel or network transporter's recommendation or on modifications which are considered by the Panel, say, to be particularly important; and

2. seeking external specialist advice before taking its final decision.

Building on these proposals it would be possible also to require Ofgem to respond publicly to written and oral challenges from this group.

The remit of the expert group would be to ensure that Ofgem had taken account of all relevant arguments and evidence, and that its analysis and conclusions were well founded and rigorous. The group would submit a public report to the Authority stating whether or not it believed Ofgem had made its case for the proposed decision. The net effect would be to put Ofgem "on the spot", thus making it more accountable for its decisions and ensuring it communicates its analysis and reasoning in a fully transparent fashion.

In Ofgem's view such an alternative approach would address any concerns that the current arrangements fail to provide sufficient accountability and transparency. Because of its relative informality, the mechanism would largely avoid the high costs and loss of flexibility associated with a formal appeal mechanism.

Ofgem therefore urges the DTI to give serious consideration to this alternative approach.

Ofgem's response to the DTI consultation falls in two parts – the first summarises Ofgem's views on the current arrangements and how they could be improved; the second covers the responses to the individual questions posed in the consultation.

Part One: Ofgem's Views

The Current Arrangements

The current arrangements for Code modifications have been highly successful viewed against the objective of creating a flexible Code governance framework. The processes now in place must be contrasted with those that previously existed, which were frequently criticised for being slow and unwieldy. The May 2003 NAO report on the New Trading Arrangements reported that "the governance of the Pool was widely recognised as inadequate and cumbersome. In designing NETA, Ofgem and the Department sought to create governance arrangements that were sufficiently open and flexible to allow modifications to be made to the rules in a timely fashion as the market developed and which incorporated adequate representation of customer interests".

Given the nature of the industry Codes – which are in effect multi-party agreements, with around 150 signatories, governing the day-to-day arrangements for trading in the energy markets – this flexibility is very important. In some cases urgent changes have to be carried through in a matter of days, for example, to protect security of supply or react to commercial events such as the collapse of Enron. It is vital that in considering changes to the Code modification process this flexibility and responsiveness is not lost.

Ability to effect changes quickly

Modification 509 provides an example of a change to the Network Code being decided upon and indeed implemented within a short time of the final modification report being submitted to Ofgem, in this case 3 days. The collapse of Enron prompted Transco to recall the prospective entry capacity held by Enron, which had been allocated to it through an auction process. As this recall reduced the available capacity below that specified in the Network Code, Transco had been releasing additional capacity (partly drawn from that recalled from Enron) on a daily basis. However, this daily release created significant market uncertainty and increased reliance upon daily markets (and therefore potential costs). Modification 509 required Transco to re-sell the prospective entry capacity that had previously been held by Enron on a monthly basis, via auction, rather than on a daily basis. This demonstrates the potential for rules and obligations within the Network Code to be amended very quickly in response to unforeseen developments.

In the consultation the DTI states clearly that in order to justify taking action in this area "there must be clear and convincing evidence that the current process is not functioning as well as it could do". It is far from clear at this stage that there is a problem with the current procedures to which a legislative change would be a proportionate response.

Already there is a high level of transparency and accountability with Panel meetings open to the public and with publication of the Panel or network transporter's recommendation and the Authority's decision, together with reasons for that decision. Changes to the Codes are proposed by Code participants – Ofgem is not able to propose modifications. Industry then has the opportunity to input its views and in some cases may suggest and develop alternatives through the consultations that the Panel or network transporter carries out. All the documentation is published on the web together with regularly updated status reports. Moreover, the facility exists within the governance arrangements of the processes themselves for industry to propose procedural changes, as they have done on several occasions.

As explained in the DTI consultation there is already a right of appeal against the Authority's decision through the use of judicial review. This provides an appeal on the grounds of procedural error, illegality or unreasonableness. This route has been used in the past to challenge the Authority's decisions on modifications. Moreover because the Authority makes its decision following a recommendation from the Panel or network transporter, it is already acting in some sense as a "second tier" decision maker. Whether a further third "tier" would add more value than cost is therefore open to question.

That said Ofgem is committed to the principles of transparency and accountability and is therefore always receptive to ways of improving the current procedures – provided that the costs (direct and indirect) of any change are proportionate.

In deciding on whether changes are required it is expected that the DTI will pay close attention to the industry's views as to what the specific issues are that they are seeking to address. From Ofgem's perspective and based on feedback we have from the industry as part of our ongoing dialogues, it would seem that possible areas of concern are:

- Ofgem is not always thought to have adequately incorporated industry views into its analysis;

- In making its decision the Authority has to have regard to its principal objective and therefore may be taking account of factors which the Panel or network transporter did not take into account in its consultation and recommendation, and on which the industry has not therefore had an opportunity to comment;

- The processes and details of individual modifications are hard for those not closely involved with the Codes to follow.

Some parties argue further that the lack of a full right of appeal on merits represents a weakness in principle and is contrary to principles of natural justice. Ofgem recognises this concern but considers that in this particular case where the decisions relate to complex operational issues concerning trading arrangements, the disadvantages significantly outweigh the benefits.

The Practical Problems of an Appeals Mechanism for Code Modifications

Given the particular nature of Code modifications there are, in Ofgem's view, real risks of a proliferation of appeals adding delay, uncertainty and cost into the process. With over 200 modifications a year and with a large proportion of cases having winners and losers, companies will have a strong commercial incentive to appeal – even if only as a tactic to delay implementation of a modification.

An example of a modification that would be susceptible to an appeal to delay implementation on purely commercial grounds

Modification 572 (to be implemented on 1 August 2003) will require shippers to provide either cash or Letters of Credit (LoC) as the sole means of security for gas energy balancing credit cover. This is already the position in electricity balancing. This change addresses concerns that neither Approved Credit Ratings (ACRs) nor Parent Company Guarantees (PCGs) have provided sufficient protection for other users in the event of shipper insolvency or increasing indebtedness. As Transco is neutral in respect of energy balancing, failure to recover such debt would result in it being smeared across the whole shipper community.

This change will not impact upon many smaller shippers (or those with less favourable credit ratings) as they are already required to provide cash forms of security. However, there was strong opposition to this modification from those larger companies which had previously enjoyed credit cover from ACRs or PCGs. This modification has the effect of increasing costs for larger companies, in order to provide increased and appropriate protection for users as a whole. Such asymmetry in the direct costs and benefits makes it more likely that the affected parties would appeal such a modification in order to delay implementation.

If the government were to introduce an appeal mechanism, it has been widely suggested that this would need to be tightly focused to avoid a proliferation of appeals. The difficulties of doing this in practice should not be underestimated. To attempt to limit the scope to "significant" decisions simply raises the question of how this should be defined, by whom and whether it can ever be done in such a way as to be robust to challenge. In Ofgem's view, restricting appeals to cases where Ofgem's decision differs from the recommendation of the Panel or network transporter would limit the number of appealable decisions and would provide clear, objective criteria for determining appealability. However, even this approach creates serious difficulties. First it would provide perverse incentives on the Panel if they know an issue to be one on which Ofgem has clear views. Second, in some cases multiple modifications are put forward which are alternatives addressing the same issue – the Panel may recommend one of them to be made but the Authority may choose another. In such cases although the Authority may be rejecting the Panel or network transporter's

recommendation it may still be agreeing the principle of the modification.

Similar issues arise with respect to 'urgent' modifications and those impacting on security of supply, which would need to be excluded from the process. While there is already a clear process for determining 'urgency' there is clearly a risk of distorting the original decision on 'urgency' if it were to be used as the basis for appealability. For security of supply to be a consideration there would need to be a direct and material effect. Given its statutory duties in relation to security of supply Ofgem would have to be able to direct certain modifications without risk of appeal. This would mean that Ofgem would have to be the arbiter of what constituted a security of supply issue – and hence appealability. There would also need to be a way of handling security of supply issues which would not fall within the current category of 'urgent' but that within the six months or so of an appeals process would become so.

In addition to the question of what decisions could be appealed there are a number of other critical issues identified in the DTI consultation which would need to be satisfactorily resolved if the introduction of an appeals process is not to prejudice the efficient functioning of the system, and where it is far from clear that a workable solution can be found.

- The time to be allowed for each of the stages of the process (making an appeal, permission stage, decision on admissibility, decision) should be set out in the legislation. Given the technical complexity of the wholesale energy markets it would take the Competition Commission a significant time to reach a properly reasoned decision. In Ofgem's view introducing an appeal mechanism could introduce at least a six month delay on contested decisions. This would represent a significant delay in the introduction of what might be important changes from the perspective of industry players or consumers. On the other hand, constraining the time available too far would risk poor quality decisions and ultimately a less effective regulatory regime. If the time allowed was insufficient for proper consideration of the issues at hand, then there is an additional prospect of judicial review of the appeal introducing further delays, risks, cost and complexity.

The cost of delay

At the start of NETA, credit calculation mechanisms forced Parties to lodge £170m of excess credit cover, at an estimated cost of £1.7m per annum. It also exposed Parties to risk by underestimating some individual Parties credit requirements by up to £30m. Accordingly, BSC Modification Proposal P2, which was approved by the Authority in October 2001, introduced changes that allowed energy indebtedness of Parties to be more accurately calculated.

However, due to a long system implementation timescale because of technical constraints, the Modification did not take effect until September 2002. The industry had to continue to lodge excess credit cover over the intervening period. A comparison of excess credit cover for the 01/02 and 02/03 Winter periods shows that after the P2 implementation, the mean excess credit lodged was reduced by over £200m, on a like-for-like basis. At a typical cost of 1% for letters of credit, this delay in implementing Modification Proposal P2 cost the industry £2m.

The risk of delays like this adding real costs to the industry would be significantly increased with the introduction of an appeals mechanism.

- The question of how to handle modifications which are being appealed (and those which build on modifications under appeal) is one to which there seems no satisfactory solution. To stop the clock would create an incentive for companies to use appeals tactically to defer implementation. Moreover it could in principle mean that implementation of all modifications should be delayed until the time for lodging an appeal had elapsed. This introduction of an automatic delay into the implementation of all modifications would have significant ramifications for the flexibility of the Code arrangements. However, the alternative of proceeding with implementation could lead to unacceptable costs in unravelling the changes, and perhaps all the trades made under the revised terms, if the appeal should be successful.

Trading risk from unwinding Modification decisions

BSC Modification Proposal P78 changed the basis upon which Parties who are out of electrical balance are charged or paid for the energy. The outcome has been that the spread between the buy and sell prices on the balancing mechanism has been reduced. As a result the risks of being out of balance changed and the prices of traded energy on the forwards markets took account of this change.

This Modification entailed system implementation costs of about £700k and has changed the behaviour of market participants. The adverse impact on trading confidence from unwinding such a modification would be likely to be way beyond and additional to the sunk costs of the central system changes and would involve speculating on what would have happened to prices absent from this modification.

- The grounds for appeal would need to reflect both the specific Code objectives and the wider duties of the Authority. If an appeal body were to decide the case based on different criteria to those which the Authority has to apply then there is a clear risk that they will reach different decisions more frequently (and even when the Authority had acted correctly in light of its duties), significantly increasing regulatory uncertainty.

- A further concern is how to ensure that consumers are not disadvantaged, in particular by ensuring that they have an equal right of appeal and that the informational and resource disadvantages they might face in raising an appeal can be overcome.

Overall Ofgem's view is that there are very real practical difficulties in designing an appeals mechanism that will not prejudice the efficient operation of the wholesale markets.

As noted above it is essential that the benefits of any change outweigh the costs. In this regard the RIA produced by the DTI to accompany the consultation is misleading in suggesting that there could be no costs associated with the introduction of an appeals mechanism.

With over 200 modification decisions each year, if only 5% of them were appealed this would mean 10 appeals a year. The Competition Commission costs for the MALC investigation were approaching £1m. Including the costs for other parties, and recognising the large number of industry players impacted by any change, a cost of £2m per appeal would be a conservative estimate. On this basis the direct costs alone would amount to well over £20m each year. In addition account would need to be taken of the delays in delivering the benefits that would arise from modifications, in particular if a 'stop the clock' approach was adopted. Alternatively allowance would need to be made for the costs of unravelling the changes. Finally, we suspect that these direct costs would be dwarfed by the indirect costs arising from increased regulatory uncertainty.

Ofgem shares DTI's commitment to the use of RIAs as an essential tool in ensuring accountability and transparency for all areas of government. It is essential that the RIA which accompanies any final decision on this issue includes a full and proper assessment of the costs and benefits of any proposed changes.

An Alternative Approach

Given the very significant risks that would arise from introducing an appeals process for Code modifications, it is Ofgem's view that a number of the DTI's other proposals (as set out in paragraphs 40-42) would represent a more proportionate response to what might be seen as issues with the current arrangements. Such changes would help improve the transparency and accountability of the process without the disproportionate costs and problems associated with introducing a full appeal mechanism.

In particular Ofgem considers that the DTI's proposals on the "Ability to influence decisions ex-ante" (in paragraph 42) could provide the basis for a workable alternative to an appeals mechanism. The essence of the DTI's revised approach was that:

- Where Ofgem disagrees with a recommendation from the Panel / network transporter, or where the decision was considered by the Panel to be particularly

important, Ofgem would publish a "minded to" statement setting out the reasons for its proposed decision;

- Industry and other interested parties would be able to make representations to Ofgem on its proposed decision;

- Ofgem might, on request, appear before the Panel to respond to questions;

- External specialist advice could be sought once Ofgem had reached an intended decision, which it would need to take into account in reaching its final decision.

In Ofgem's view this could provide the basis for a workable solution if, for example:

- An Independent Scrutiny Board were set up as a standing group (whose membership might include retired industry representatives, academics, foreign regulators, regulators of other sectors, or other suitably qualified and independently minded people) to provide the external specialist advice;

- For significant decisions where a "minded to" statement had been issued, any party eligible to make modifications could request that the Independent Scrutiny Board review the proposed decision;

- Ofgem would agree to respond in a public forum, and be subject to cross-examination by the Independent Scrutiny Board (rather than the Panel as suggested by the DTI as this would also then cover Network Code and CUSC);

- The Independent Scrutiny Board would submit a public report to the Chairman of the Authority assessing whether or not Ofgem had made its case;

- Ofgem would then make a final decision after considering the points raised in the Scrutiny Board report, as envisaged in the consultation;

- In addition there may be scope to pursue the DTI's proposal for improved transparency (in paragraph 40), in particular to help those less closely involved with the process.

The alternative approach outlined above would address a number of industry concerns. In particular it would ensure that industry had an opportunity to comment where the Authority might be taking account of factors not covered in the Panel or network

transporter consultation and would provide an opportunity for them to seek directly to influence the Authority's thinking. It would also increase accountability by forcing the Authority to defend its decision in a public forum – to put them "on the spot" as it were. The existence of a report by the Independent Scrutiny Board assessing whether the Authority had made its case could also be expected to provide support for any party wishing then to judicially review the Authority's decision.

Given that the challenge would come in advance of the formal decision being made the practical question of whether or not to stop the clock would be avoided. The use of a standing group of experts would reduce the time required for them to get up to speed on the issues and to form a view. Moreover the more informal approach would lead to markedly lower costs then would be involved with a legal appeal to the Competition Commission.

Such an approach could be introduced without recourse to primary legislation which would allow it to be adapted in the light of experience. Given the government's commitment to "light touch regulation" there would seem to be a strong argument for starting with a non-statutory approach. Clearly there would be nothing to stop government introducing a formal appeals mechanism in future if the alternative approach proved to be inadequate.

Overall such an alternative approach would address many of the potential concerns about the current process while avoiding the major risks in terms of delay, cost and regulatory uncertainty that an appeals mechanism would entail. As such it would seem to be a more proportionate and clearly preferable approach.

Conclusion

In summary, Ofgem does not consider that the modification process will be enhanced by an appeal process but, rather, considers it would be a disproportionate and costly response. The introduction of an appeals mechanism for these particular decisions would introduce delay and uncertainty into a process where flexibility is particularly important. Ofgem is not persuaded that the benefits of such a change would outweigh the costs and considers that some of the other changes proposed by the DTI would represent a more proportionate and cost effective response. If the government decides that it does, nonetheless, wish to proceed with an appeals mechanism then very careful thought would need to be given to the detailed design in order to minimise the risks of serious problems arising from its implementation.

The difficulty of finding a satisfactory and robust solution to all the issues identified in the DTI consultation should not be underestimated and in practice there may be no satisfactory solution to a number of the issues identified.

An alternative approach would be for Ofgem to publish a 'minded to' decision if it expected to deviate from the recommendation of the Panel or network transporter, and then respond publicly to oral and written questions from an Independent Scrutiny Board. This would give many of the advantages in terms of improved transparency and accountability with significantly lower costs.

Part Two – Response to DTI Questions

1. How have the individual Code modification processes worked compared to expectations at the time they were introduced?

One of the objectives of the DTI/Ofgem proposals for the New Electricity Trading Arrangements (NETA) and the earlier Monopolies and Mergers Commission report into British Gas and the gas market was to introduce flexible Code governance frameworks that would allow industry participants to propose changes to the trading arrangements in a manner that would allow regulatory and commercial interests to be balanced appropriately.

October 1997 marks the genesis of the current electricity governance framework when the Minister for Science, Energy and Industry invited OFFER to consider how the electricity trading arrangements might be revised. The review confirmed many of the concerns about the Pool-based trading arrangements. A chief conclusion was that the Pool governance was not conducive to change, with no significant role for customers or OFFER. The proposals suggested by OFFER were to put in place market-based trading arrangements more like those in commodity markets and competitive energy markets elsewhere. These proposals were accepted by the Government as the right way forward in October 1998 in its White Paper.

In November 1998 a framework document was published which explained how the NETA programme for the reform of electricity trading arrangements would be taken forward. An intensive programme of work under DTI and OFFER/Ofgem direction and involving all interested parties culminated in the publication of more developed proposals in July and October 1999. During 2000, these proposals were further developed and clarified, with special consideration given to the issues raised in the October 1998 White Paper.

In order to introduce NETA into England & Wales, it was necessary to introduce new arrangements for balancing and settlement contained in the new Balancing and Settlement Code (the 'BSC'). In addition, it was necessary to make changes to existing industry Codes to reflect the new arrangements (i.e. the Grid Code, the Master Connection and Use of System Agreement (MCUSA) which was replaced by the Connection and use of System Code (CUSC), the Master Registration Agreement (MRA) and a number of other industry documents).

The May 2003 NAO report on the New Trading Arrangements reported that "the governance of the Pool was widely recognised as inadequate and cumbersome. In designing NETA, Ofgem and the Department sought to create governance arrangements that were sufficiently open and flexible to allow modifications to be made to the rules in a timely fashion as the market developed and which incorporated adequate representation of customer interests."

The origin of the Transco Network Code can be traced back to proposals put forward in the 1993 Monopolies and Mergers Commission report into British Gas and the gas industry which were subsequently taken up by the DTI and led to the 1995 Gas Act. The Act provided for the creation of a comprehensive code of practice for the regulation and use of the gas network, known as the Network Code. A fundamental rationale related to providing parties access to the network on a non discriminatory basis. The measures implemented enabled industry to respond to circumstances in a flexible way.

Overall, the Code processes have performed well compared to expectations when they were set up allowing incremental changes to be made to the arrangements. In the gas sector, since 1996, there have been over 625 proposals for change processed through the governance framework of the Transco Network Code. Of these proposals, 346 have resulted in approved modifications. Changes as significant as introducing long term and short term auctions (M500, M350) and introducing the on-the-day commodity market (M311) have been made through the Code modification process. In the electricity sector, since March 2001, 172 proposals for modification or amendment have been submitted to the governance frameworks of the BSC and the CUSC. Of these, 81 have resulted in changes to the arrangements. In the electricity sector, the governance framework has proved sufficiently robust to effect changes as substantial as shortening Gate Closure from 3.5 hours to one hour (BSC Modification Proposal P12); improving the transparency of the BSC governance arrangements (BSC Modification Proposal P28); and revising the imbalance exposure element of the payment mechanism for participants providing mandatory frequency response (CUSC Amendment Proposal CAP1).

The frameworks have also delivered the expected flexibility to enable industry to react to sudden exigencies such as those which accompanied the collapse of Enron in 2001 or to remedy the severe price spikes that occurred during the initial stages of NETA. Changes to the Codes have been made on the basis of proposals submitted by all classes of parties, irrespective of size or market influence.

In summary, the Codes have been highly successful in delivering the flexibility that was one of the primary objectives in their design.

2. What are the strengths and weaknesses of the existing Code modification processes?

Strengths

The strengths of the Codes governance framework include:

Flexible governance arrangements which enable changes to be made to fundamental elements of the Codes efficiently and as speedily as demands dictate.

1. Rigorous evaluation of proposals involving extensive consultation.
2. Transparency and openness of proceedings.
3. Evaluation bodies such as the Panels, Working Groups and Modification Groups which are designed to operate in an objective and equitable way and to encourage inclusivity in the modification process.

These points are considered in more detail below:

Flexible arrangements

The Urgency procedures are a feature of the process which allow for proposals in certain circumstances to be evaluated along shorter timescales. This mechanism enables industry to react appropriately to quick changing circumstances.

Further, Ofgem can alter the timetable for processing proposals if they consider circumstances prevailing at any time merit more expeditious or extended evaluation.

Further examples of flexibility include the provisions in the Codes which grant the Panels the discretion to send proposals straight to consultation and to bypass the relatively costly evaluation procedures if the Panel considers that the proposal very clearly facilitates achievement of the Code objectives. In the electricity sector, the Panels also have discretion to amalgamate proposals that are similar in intent or to reject proposals if they are similar to pending proposals or similar to proposals submitted within two months of an Ofgem decision not to direct a modification or amendment. Under the Transco Network Code

proposals cannot be amalgamated but where, for instance, they are superseded by an alternative proposal they may be withdrawn at any stage by the proposer.

Another efficiency measure provided by the Codes is that before engaging in further analysis that might prove expensive, the Codes permit the Panels to seek the provisional thinking of Ofgem on the issue.[2]

This flexibility, and in particular the ability to expedite modifications where necessary, is a central feature of the current arrangements and one which is of critical importance given the nature of the Codes.

Rigorous Evaluation Involving Extensive Consultation

The governance of the Codes enables rigorous evaluation of proposals but in a way which is proportionate to the complexity of the issues raised. The BSC for example provides for three distinct evaluation approaches where issues raised in a proposal can be defined in sufficient detail to enable the Panel to decide whether to send the proposal straight out to consultation, to send it back to the Modification Group for further analysis or to send it to be assessed by the Modification Group to determine whether the proposal facilitates achievement of the Code objectives. In addition to the analysis by industry experts, where appropriate, analysis and impact assessments may be commissioned from the network transporter, party agents, external consultants or advisers with specialist knowledge in the subject area to which the proposal relates.

In the electricity arrangements, in order to determine the feasibility of making a proposed change, the Code modification processes allow for the preparation of project briefs setting out the proposed steps and timetable for such implementation. In the gas arrangements the Transco Network Code is more operational than systems orientated with consideration of the latter being subject to the governance of the UK Link Committee.

Under the provisions of the BSC, and generally in practice for the Transco Network Code and the CUSC, not even the most minor of proposed changes arrives at Ofgem for a decision without having been consulted upon by interested parties. In almost all

[2] In all the Codes the objectives relate broadly to facilitating competition or facilitating the efficient discharge of the network transporter's efficiency obligation as set out in their licence.

cases, before a change can be made to any of the Codes, a consultation will take place to enable parties to comment on whether the final legal text intended to give effect to the change adequately reflects the intention of those making the recommendation.

Under the provisions of the licences to which they relate, it is possible for changes to be made to both the Transco Network Code and the CUSC by means of "consents to modify" in which case consultation may not be required. However this course of action has only been used to effect very minor changes, such as the correction of typographical errors or general housekeeping changes.

In general the existing arrangements for consultation provide a high level of transparency and accountability.

Transparency and openness of proceedings

Subject to confidentiality and practical constraints, meetings of the Code Panels, Modification Groups and Working Groups are open to anyone who wishes to attend. Further, throughout the course of the evaluation of a proposal and subsequent to a decision NGC, Transco and Ofgem will publish documents and letters relating to the proposals and the final decisions on their websites and public registers respectively. Modification decision letters will also be available on Elexon's website.

In the gas sector, Ofgem recently set out its intention to increase the transparency of its involvement in the modification process. To this end, Ofgem now publishes its decision letters on a dedicated section of its website. In addition, the criteria which Ofgem use in order to determine whether a proposal warrants Urgent status have also been placed on the website for reference. Future decisions on granting a modification Urgent status will specify how those published criteria are satisfied. Ofgem has also undertaken to publish more information on the progress of modification proposals which again will be available on the website.

Equitable elements of the process

The Code governance arrangements enable a balance of views to be factored into the decision making.

(i) *Partially elected Panels:* The modification processes of the Transco Network Code, the BSC and the CUSC feature the involvement of Panels tasked with

ensuring that the Code modification procedures are adhered to and, in the case of the BSC Panel, making a recommendation to Ofgem. These Panels are composed in large measure of parties elected by industry itself. In the electricity sector, the non-elected Panel members (such as Consumer or Distribution appointees) are appointed for their expertise in areas relevant to the consideration of proposals and because of the impact Code changes may have on groups they represent. The BSC Panel also has two Independent members.

Modification Panel representatives of the Users of Transco Network Code (shippers) are nominated and elected through the Gas Forum. In addition, the representatives of interest groups such as terminal operators, suppliers and consumers may be appointed, though currently as non-voting members of the Panel.

(ii) *Recommendations made according to objective criteria:* As regards the evaluation of proposals, members of Transco, NGC and the BSC Panel (the Recommending bodies) are obliged, whatever their interest or company stance to make their recommendations according to objective criteria set out in advance. The criteria broadly relate to facilitating efficiency in the arrangements and to promoting competition in the areas to which the Code relate. These Code objectives serve to prevent the introduction of unfair barriers to entry and to safeguard parties from being adversely discriminated against. Ofgem report on the extent to which these obligations were met by those tasked with evaluating proposals.

(iii) *Clear lines of accountability:* The Codes contain provisions that confer clear responsibility on specific groups for particular obligations under the Code modification processes. The roles of the different parties provide built in checks and balances (see question 8).

(iv) *Standing groups:* The Codes provide for standing groups comprised of industry experts to discuss issues relating to the sector. These standing groups enable industry participants to discuss issues and develop modification proposals to address them.

Perceived weaknesses

(i) In coming to a decision on a proposed modification Ofgem will have regard to the applicable Code objectives and its wider statutory duties which may include factors that may not have been considered and evaluated by industry experts or consulted upon. Whilst this could be perceived as a flaw in the process, the Code processes do permit parties to request provisional thinking or minded to views from the Authority prior to the close of the evaluation process. While the existing provisions could therefore provide an adequate solution, Ofgem accepts there are merits in the DTI's proposal, as set out in Part One, that it should provide a minded to statement prior to publication of a final decision on a proposal whenever it intended to depart from the Panel or network transporter's recommendation or where the modification is significant.

(ii) Ofgem is aware of concerns that the Modification Rules of the Transco Network Code are not themselves subject to the same robust governance and therefore not as amenable to change as other Codes. Whilst changes to the Transco Network Code Modification Rules are subject to the consent of the Authority, following consultation, they are currently progressed through the auspices of the Prioritisation sub-group of the Network Code Committee which is not perceived to be as transparent and accountable as its Network Code counterparts. In an open letter to the industry in April 2003, Ofgem stated its intention to consider further whether it remained appropriate for the modification rules to lie outside the Transco Network Code itself and invited views in this regard from industry. This highlights the point that there is flexibility for improvements to be introduced to the arrangements without recourse to primary legislation.

(iii) Ofgem is aware of opinion within industry that it has excessive discretion when coming to a decision and does not adequately listen to industry views. In decision letters, Ofgem relates its decisions to the relevant objectives of the particular Code and to its statutory duties which are transparent to all participants. One effect of the alternative approach described in Part One of

this response would be to put Ofgem "on the spot" and force it publicly to defend its decisions.

(iv) In response to consultation on Code governance proposals, some Code signatories have complained that the whole change mechanism is a lengthy process. Under the non-urgent route, the process from submission of the proposal to it arriving with Ofgem for a final decision can take up to six months. The introduction of a formal appeal stage would obviously exacerbate this problem.

(v) In response to consultations, Code signatories have complained of consultation fatigue. In the BSC for example, in respect of more complex proposals which may have a material impact on the trading arrangements, as many as four consultations may take place prior to the final report being submitted to Ofgem for a decision. Two separate consultations can attend even the most minor and uncontentious of changes. Adding further stages into the process could make this worse.

(vi) The processes and details of particular amendments can be difficult for those not closely involved with the Codes to follow. Given the inherent complexity of the Codes and the wholesale markets this is perhaps inevitable. However, where it is clear that there is wider interest in a particular amendment (for example on enovironmental grounds) then it may be helpful to consider more carefully how best to communicate the issues.

3. What shortcomings do you see in the transparency and accountability of the existing Code modification processes which require change?

Ofgem is not persuaded that there are any shortcomings in the existing processes which require change through primary legislation. Parties are free now to propose changes to the BSC and CUSC to address perceived shortcomings in the transparency and accountability of the governance framework. Since March 2001 Ofgem has received three BSC proposals dedicated to the improvement of the transparency of the governance arrangements. These

proposals were amalgamated into P28 and Ofgem made a direction on the proposed modification. As a result (i) all non-confidential (Panel and Committee) business is held in open session, where practical. The default position and presumption is that meetings are in open session and it is for the Chairman, on grounds of practicality or confidentiality, to decide otherwise.[3] (ii) All Modification Group business is held in open session by default, subject to confidentiality/practicality.

There is considerable flexibility within the existing governance arrangements for them to change and develop. In addition, as explained in Part One, some of the DTI's alternative proposals could provide a non-statutory solution to many of the weaknesses identified in response to question 2.

4. An appeals mechanism or other methods of improving transparency and accountability in the Code modification process would introduce another layer to the process. Can we ensure this extra layer improves decision making and is not unnecessarily burdensome?

In Ofgem's view there is no satisfactory way of ensuring that the introduction of an appeals mechanism would not simply add delay and cost. It will only improve the quality of decision making if sufficient time is allowed for the Competition Commission to get to grips with what are some technically complex issues – but in so doing it will inject significant delay and cost into a process where flexibility and timeliness of decision making is actually of paramount importance.

While the introduction of additional steps will of course always introduce some cost and delay, Ofgem considers that the alternative approach set out in Part One represents a more proportionate approach.

5. How well are customers represented in the current process?

In the electricity sector, energywatch have two representatives on the BSC Panel to comment on possible impacts on domestic consumers and one representative on the CUSC Panel. Two individuals from energywatch may attend the Panel of the Transco Network Code as consumer representatives, though they have no voting rights. However, in September 2002

[3] The Trading Disputes Committee and the Performance Assurance Board remain confidential.

Ofgem implemented changes to Standard Conditions 4E and 9 of Transco's licence. The latter requires Transco to recognize Third Party Participants who are not Code signatories, by permitting them to raise modification proposals to all or part of the Code. The licence amendments were made as a result of concerns highlighted to Ofgem by customers and market participants. Transco has recently undertaken consultation on changing its Network Code Modification Rules in order to facilitate the discharge of this obligation.

Ofgem considers energywatch's role in the process to be essential, though it is recognised that with regard to technical issues such as these they have limited resources.

6. How well are new entrants to the industry represented in the current process as opposed to longer standing industry members?

By contrast with the longer standing industry members, new entrants would not have been eligible for the election process; neither would they have been able to nominate parties for election to the Panels. They are nevertheless able to attend and to participate in meetings and they are consulted upon to the same degree as all other parties. One observation however is that the longer standing industry members tend to be the most frequent respondents to consultations.

The key point however relates to potential new entrants. Industry incumbents have no natural incentives to design rules that facilitate entry and foster competition. It is in this context that the roles of Ofgem and energywatch are essential. Again it is useful to compare current arrangements with the old Pool, where incumbents were able for the whole lifetime of the regime to frustrate the introduction of effective Demand Side participation (which can be viewed as a form of entry).

7. How effective is the role and accountability of Ofgem in the current process?

Ofgem has various roles and powers in respect of the Codes. In the main, these powers operate as a check on the powers of the network transporter and Panel in the interest of the efficient operation of the Codes. For example, Ofgem has to give formal assent before a proposal can be granted Urgent status; Ofgem can alter the timetable set by the Panel for evaluation of a proposal or can assign a different priority to the evaluation of proposals. Ofgem has to approve any request to shorten or lengthen the timetable for implementation of an approved modification or amendment. Similarly, in the electricity sector, any request made in the interest of efficiency not to prepare legal text has to be approved by Ofgem.

Ofgem can issue a notice to the Panel not to reject proposals for being similar to pending proposals or not to amalgamate proposals. Ofgem may provide provisional thinking, where requested to do so by the Panel.

As regards accountability, all Ofgem decisions made pursuant to the above mentioned powers are subject to judicial review and Ofgem provide, in the form of decision letters, detailed reasons why proposals have been approved or rejected. These decision letters also provide a report on the Code procedure followed so as to demonstrate that due process has been adhered to. Unlike with the licensing regime which is often cited as an area where the ability to appeal exists, Ofgem has no power unilaterally to propose modifications or amendments to any of the Codes.

Ofgem's role in respect of the evaluation of proposals prior to submission of the final report is strictly limited. Ofgem has no vote on the Panels or in Working Groups or Modification Groups. Its status is that of an observer. During the evaluation of a proposal, Ofgem may advise on regulatory aspects such as the impact a proposal might have on the licensing regime or on previous Ofgem decisions relevant to the proposal under evaluation.

Consultation responses from papers such as Elexon's BSC Review or responses on modification proposals themselves have been illustrative of industry ambivalence towards the role of Ofgem in the Code governance framework. While a few have complained of excessive regulatory intervention in the process, others claim that parties have little idea of Ofgem's stance on a proposal until the final decision has been made. In response, Ofgem considers that a non-interventionist role during the evaluation phases of the procedure is in keeping with the rationale behind the Codes and serves to enable Parties to develop proposals independently according to their own perception of what would better facilitate achievement of the Code objectives.

8. Does the current governance framework contain sufficient checks and balances to ensure that Ofgem and other participants play their appropriate roles?

The checks and balances afforded by the various Codes differ in minor respects, but in each case they serve to ensure that proposals are evaluated in an even handed way and to limit the opportunities for any class of parties or evaluation body to exercise a disproportionate or an inappropriate influence on the outcome of the evaluation. A number of different parties are involved in the Code modification process and there are checks and balances on each to ensure they fulfil their role in an objective and even-handed manner.

Checks and balances on the Network Transporter (NGC and Transco)

In the CUSC and the Transco Network Code, the obligation to deliver the final amendment report or modification report to Ofgem for a decision lies with the monopoly network transporter. On both those Codes, the Panels serve as a check to ensure that due process has been adhered to and that proposals have been adequately evaluated before submission to Ofgem. The Panel and not the network transporter sets the timetable for evaluation of proposals and the Panel determines their priority; the Panel sets the terms of reference for the groups evaluating the proposal; the Panel can make recommendations for Urgency. Along with the network transporter's recommendation, the Panel's views are submitted in the final report to Ofgem. A further check on the network transporter exists in the way the recommendation of the network transporter has to be made on the basis of objective criteria.

A check on NGC's power as network transporter to submit the final report to Ofgem exists in the way the CUSC Parties can submit alternative proposals to the main proposal during the consultation phase of the process. NGC are obliged to submit these alternative proposals, which in effect are alternative means of effecting the change proposed in the original proposal, to Ofgem along with the final report.

Checks and balances on the Panel

The Panel can recommend Urgency but Ofgem first has to approve the recommendation and approve the timetable. NGC also has the power to make recommendations for Urgency. On all the Codes, the Panel is obliged to act impartially. Under the BSC the Panel makes its recommendation on the basis of objective criteria. Even in circumstances where the Panel use their discretion to send a proposal straight to final consultation because they consider that it clearly does not better facilitate achievement of the Code objectives, Ofgem can nevertheless request legal text that would enable them to make a direction.

Checks and balances on Working Groups/Modification Groups

It is the Panel which sets the terms for reference of the evaluation groups such as Working Groups and Modification Groups. The Panels have the power to refer proposals back to the evaluation groups if they consider that the proposal has not been evaluated sufficiently. Like Panel Members, members of Working Groups and Modification Groups have to come to their recommendations according to objective criteria. In the BSC they are obliged to act impartially in coming to their recommendations.

Checks and balances on Elexon

In the BSC, Elexon representatives have no vote on the Panel and can make no recommendation on the merits of a proposal. Elexon are a limited company and the extent of their actions with regard to the BSC is governed by their memorandum of association which is treated as incorporated in and forming part of the BSC.

Checks and balances on Ofgem

Although Ofgem makes the final decision on a proposal, Ofgem has no vote on the Panel or in Working Groups or Modification Groups. Ofgem's role is that of an observer during the evaluation stage. In particular Ofgem can only intervene and provide provisional thinking on the merits of a proposal when requested to do so by the Panel. Another check on Ofgem is that it has no power to grant Urgent status to a proposal unless a recommendation is made first by the Panel or by the Network Transporter.

Ofgem's decisions are made with regard to the applicable Code objectives and its wider statutory objectives which are transparent to all parties.

9. What are the pros and cons of introducing an appeals mechanism?

One argument in favour of an appeals mechanism relates to questions of natural justice where Ofgem is making decisions which impact materially on a company. Ofgem has no objection to appeals mechanisms in principle and considers it right that it should be accountable for its decisions.

However, in the particular case of Code modifications there are very real and practical problems with introducing an appeals mechanism, given the number and nature of the modifications. In particular:

- With over 200 modifications a year and with 150 signatories to each Code there is a real risk of a proliferation of appeals. Since a large proportion of modifications have winners and losers, companies will have a commercial incentive to appeal, even if only for tactical reasons. A high number of appeals would add significant cost and delay into the system.

- The issues involved are technically complex and the Competition Commission would need to be allowed a reasonable time (probably six months or longer) to

reach a decision. Given the importance of flexibility and the need, in some cases, to take swift action to address security of supply concerns, this sort of delay would jeopardise the effective functioning of the wholesale markets.

- The question of how to handle modifications which are subject to appeal is an intractable one. To stop the clock creates an incentive to appeal on tactical grounds and would mean that implementation of modifications would have to be delayed until the period for lodging an appeal had passed. The alternative of having to unwind both implementation of the modification and the trades that had taken place under the revised arrangements should an appeal succeed is almost as unattractive.

- The costs of dealing with appeals (both industry's costs and Ofgem's costs which would be passed on in licence fees) would ultimately fall on consumers.

In summary there are very significant problems with introducing an appeals mechanism for Code modifications such that the costs outweigh the benefits – in particular given that there are alternative ways of improving transparency and accountability of the modification process which provide a more proportionate solution.

10. What are the main issues which need to be considered in designing an appeals mechanism and how could they be resolved? Please refer to paragraphs 30-38

It is assumed that the reference is meant to be to paragraphs 44 – 56

As indicated in the consultation, the main issues to be addressed in designing an efficacious appeal mechanism can be listed as follows:

Minimising the risk of proliferation of claims – Given there are about 150 parties to each of the Codes that are the subject of this consultation and given that on average, 200 proposals are processed through the Codes each year involving decisions on issues that may create winners and losers, appropriate eligibility criteria would have to be built in to mitigate against the risk of the process and the implementation of proposals being slowed down by the consideration of a multitude of appeal claims. Ofgem is not persuaded that such a filter can be developed that would be robust to challenge. The eligibility criteria should if possible include measures to prevent or at least minimise the possibility of better-resourced parties using the appeal route as a filibustering ploy to stall modifications made in the interest of the consumer, the successful implementation of which may adversely affect those parties financially. Again, however, it is not clear in practice how this could be achieved. Another

proposal in the consultation document was that the proposed appellate body would first have to grant leave to appeal before a claim could be considered. This would seem essential although it is likely to have only a limited impact on the number of appeals that would be heard. Some other limiting factors are considered below.

Establishing the standing of appellants - It has been suggested that, as for appeals under the Enterprise Act 2002, the right to appeal here should be limited to persons aggrieved by a decision and who have a sufficient interest in that decision. This is in accordance with current judicial practice in granting permission to appeal. For Ofgem, the standing of the consumer is of paramount importance as our principal statutory objective relates to consumer protection. It would seem unfair if trading parties had greater eligibility to appeal a decision made in part on the basis of consumer protection, than the consumer himself/herself – although even with an equal right of appeal there are issues in terms of the information and resource advantages that companies have. It has been suggested that energywatch could act on behalf of consumers in this context and in practice individual domestic consumers are unlikely to have an interest in appealing – although larger I&C customers may well do.

Determining which decisions should be open to appeal? – In order to focus the scope of appeals, it has been suggested that the right of appeal should be limited to cases where Ofgem's decision goes contrary to the recommendation of the Recommending bodies. This might at first seem to be an effective filter but may create perverse incentives for the recommending bodies if they know Ofgem have strong views on the issues raised by the proposal under consideration. A further complication arises where there are multiple modifications addressing the same issue where the Panel may recommend one of the changes but the Authority may direct another which has the same objectives.

Treatment of urgent proposals – Given the importance of security of supply, it is has been suggested, in Ofgem's view appropriately, that urgent proposals relating to security of supply should be excluded from any proposed appeals process. There is already a process for designating proposals as Urgent. However if such Urgent proposals were excluded from the appeal process the eligibility or otherwise of a proposal for appeal would in effect depend on the network transporter or the Panel and their decision to recommend or not to recommend Urgency prior to evaluation of the proposal. This would not be satisfactory given Ofgem's duty in relation to security of supply and also would not capture all appeals with a potential to impact on security of supply in the timescale of, say, a six month appeal. There would

therefore be a need to redefine what would be considered as Urgent and also potentially to introduce a new and separate category of Security of Supply Related modifications.

Establishing the grounds for appeal – Because Ofgem has to consider broader objectives than the Recommending bodies when coming to a decision, careful thought has to be given to establishing the grounds for appeal. It would be inappropriate, for example, to use a public interest test given the original decision was not arrived at according to public interest criteria. Clearly, any appellate body ought also to have to make their decision according to the same criteria on which Ofgem came to the original decision. If not, the danger would be that both bodies could quite properly arrive at different conclusions.

Establishing who would be an appropriate appellate body – The Government have indicated that the appropriate body would be the Competition Commission.

Establishing appropriate time limits so as to minimize market uncertainty – The consultation suggests timescales for lodging an appeal of between 4 weeks and 3 months. Keeping this timescale as short as possible is important in terms of minimising market uncertainty. This is particularly important if a "stop the clock" approach were to be adopted given that implementation of all appeals would have to be deferred until the time period for lodging an appeal had expired.

To minimize market uncertainty, the appeal body should provide a response on whether leave will be granted within two weeks of receipt of the application. An appropriate time limit would also need to be set for the appellate body to reach its decisions on the substance of the appeal. Given the technical complexity of the issues it is likely to take the Competition Commission some time (say 6 months) to reach a decision. Reducing this too far would only lead to poor quality decisions but equally this sort of delay in implementing modifications could lead to significant consumer detriment.

Determining what remedies the appellate body would be able to provide – It has been suggested that the appellate body should have the ability to provide alternative directions to those originally provided by Ofgem. The impact on market certainty of an appeal body capable of overturning a direction made by Ofgem could be considerable. In Ofgem's view the options available to any appeal body should only be to accept or reject (and refer back) Ofgem's decision.

Costs of the appeal – Two considerations apply in relation to costs. Firstly, the cost of bringing an appeal should be high enough to deter frivolous and/or vexatious claims and not

so high as to prevent legitimate claims. Secondly, there is a concern about the general cost to industry and Ofgem of implementing an appeal mechanism that will function effectively. It is not clear that the benefit gained will be commensurate with the cost that may be incurred. Ultimately any cost incurred by Ofgem will be passed on to the consumer.

Handling modifications and amendments during appeals – Two options present themselves: to stop the clock pending resolution of the appeal or carry on with implementation and undo the decision if necessary. Stopping the clock would create an incentive for companies to appeal on tactical grounds to delay implementation. Moreover, as noted above, implementation of all modifications would have to be delayed until the time period for appeals had passed. On the other hand carrying on with implementation could mean that all the trades carried out under the new terms would need to be unwound at considerable expense. Neither option is attractive.

Application to Independent Gas Transporters' Network Codes – The consultation refers only to Transco's Network Code. A question that would need to be addressed is whether any appeals mechanism should also apply to the Network Codes of Independent Gas Transporters on the grounds of non-discrimination. Given the low numbers of customers on such networks it could be seen as disproportionate to include them.

11. How would the introduction of an extra layer of process to improve transparency and accountability affect the role of the Code Panels?

In circumstances where the BSC Panel's recommendation or the recommendation of the network transporter is in accord with Ofgem's final decision, the introduction of an appeal mechanism would mean that this recommendation would be open to scrutiny as well. The possibility that their decisions may be subject to further scrutiny may make the Panel less inclined to exercise their discretion to send proposals straight to consultation, for example. There may be a tendency on their part to send every proposal for full evaluation irrespective of how ostensibly minimal the changes proposed or however uncomplicated the issues raised in the proposal might seem.

If an extra layer of process were introduced by having an appeal mechanism, the BSC Panel may consider they need to provide their recommendation on a more formal footing than at present. Currently the Panel Chairman will go around the table and invite each voting Panel Member to vote on a proposal and to provide a view as to whether or not it facilitates achievement of the BSC objectives. Some Panel members are more expansive than others in

this regard and in the interest of clarity and transparency it may be considered necessary for individual BSC Panel members to provide their recommendation in a written form. This could have the effect of extending the Code modification timetable.

Another factor to be considered is whether the imposition of an appeal route may induce extra caution on the part of Recommending bodies and the Panels to the detriment of the efficient running of the process.

12. What are the pros and cons related to the alternative options for strengthening the accountability and transparency of the Code modification process outlined in paragraphs 39-41

It is assumed that the reference is meant to be paragraphs 40 – 42

1. ***Improving Transparency*** – Ofgem already provide full explanations of the reasoning behind their decisions and are committed to providing Regulatory Impact Assessments on major new policies. However, if the conclusion of the consultation is that more needs to be done to make the process more accessible to those less closely involved in the process then further effort could be put into communication.

2. ***Procedural clarity and best practice*** – While there are no immediate steps that Ofgem would propose in this area, clearly if industry felt there were specific changes that could usefully be made then Ofgem would be happy to consider them.

3. ***Ability to influence decisions ex-ante –*** The options identified by the DTI have the potential to significantly improve transparency and accountability without the disadvantages of a formal right of appeal. Building on these proposals Ofgem has set out in Part One of its response how such an alternative approach could work in practice.

4. ***Ability to challenge decisions ex-post*** – The option of alternative dispute resolution would not be appropriate given the number of parties with an interest in the decision.

13. Are there any other options which could be used to strengthen the transparency and accountability of the Code modification process and address the concerns identified in Chapter 1. What are the relative pros and cons of these other options?

An alternative option exists in the form of a slight variant of one of the options identified by the DTI.

In Ofgem's view an effective alternative mechanism to improve transparency and accountability could involve Ofgem in issuing a "minded to" decision in significant cases and submitting that "minded to" decision to scrutiny by an Independent Scrutiny Board. This alternative approach is described more fully in Part One of our response.

The advantages of such an approach would be increased transparency, greater industry participation, increased public scrutiny and the ability to influence Ofgem's final decision.

The use of a standing Panel of experts would mean that they do not need to spend time understanding the mechanics of the wholesale market before reaching a decision and hence would be quicker and less costly. A less legalistic approach would also help contain the costs.

In addition the fact that the challenge would come before the final Ofgem decision means that problems would not arise in terms of stopping the clock.

Overall this would seem to be an effective and more proportionate approach.