

Uniform Network Code, Transportation Charges and Agency Governance following the sale of Gas Distribution Networks

A Shipper View (Initial Thoughts and issues)

Background

Good governance whether it is of a commercial, voluntary or government organisation depends on establishing a framework in which robust, rational decisions can be made. It requires checks and balances throughout the whole process, including the opportunity challenge and scrutinise positions, actions and decisions of all participants. In the case of the uniform network code (UNC) this includes Transco, DNOs, the process manager, shippers, customers, and ultimately Ofgem and the Authority.

Good decisions are dependant on decision makers being presented with and being aware of the diversity of stakeholder views. They must have due regard to those that are directly or indirectly affected by particularly decisions. The effectiveness of any process is dependant on active participation of stakeholders. Parties will continue to participate if they feel their views are being listened to by decision makers, and it is this that helps maintain the ongoing quality of decision making. Unfortunately, there is evidence to suggest that involvement of stakeholders in the network code modification process is reducing. Industry code processes that are unduly bureaucratic or be run by organisations that have little financial incentive to keep the costs under control also tend to alienate the stakeholders they claim to serve.

In terms of the governance of the UNC it is important to prevent particular stakeholders or groups of stakeholders dominating the process or having undue influence over recommendations/decisions.

The original network code modification procedures were established in 1996 and perhaps reflect a perceived need by the then integrated British Gas to carefully manage and control changes to its new network code. This followed a period of sustained pressure from Ofgem and shippers liberalise the supply market. With the establishment of a (near) fully competitive market for shipping and supply by late 1990s relationships and influences changed. In this new less confrontation environment a modification process so skewed in Transco's favour seemed hard to justify.

Concerns about the modification process have been voiced by shippers for a number of years. The likely sale of DNs and the fact that Transco may sell perhaps 35% of its network assets to others now means arguments in favour of maintaining the current arrangements are unsustainable. Transco must relinquish direct control over the network code modification process and share the responsibility for governance of national charging methodologies with the independent DNOs.

In this new world what are the features that are likely to lead to future good governance of the uniform network code?

(Governance of charging methodologies and corporate governance of the agent are considered later in the paper).

- Independent management of the modification process.
- Recommendations made by Panel rather than Transco.
- Panel must represent the diversity of stakeholder views
- Panel must not be remote from the industry.
- Timetable for assessment determined by Panel.
- Safeguards in place to avoid filibustering or inappropriate 'fast tracking'
- Consistent treatment of modification proposals.
- Democratisation of IT decisions impacting agent's central settlement systems
- Scope for Panel/Panel Committees to make decisions
- Safeguards for delays to Authority decisions

1. Independent management of the modification process

Shippers and other stakeholders generally acknowledge that Transco manage the current process in a professional and cost effective manner¹. There is uneasiness about amongst shippers about adopting many of the bureaucratic and inflexible processes that are to be found at the heart of the electricity balancing and settlement code (BSC) modification procedures. Nevertheless lessons (good and bad) can be drawn from the experiences of other industry codes

At times the current network code arrangements allow Transco to adopt a highly partisan approach to the management of the process. In such circumstances the chairing of workgroup meetings reflect Transco's priorities, consultations responses are considered with greater or lesser vigour and modification reports give more emphasis to Transco's views. Wherever this partisan approach is apparent shippers and other stakeholders tend to make other representations to Ofgem rather than solely rely on how their views have been reflected in the final modification report.

It is interesting to note in Transco's UNC Governance - thoughts and issues paper they state;

"If governance was removed from Transco/GTs it would be reasonable to expect them to submit detailed representations to Ofgem for consideration at the time any modification report was made."

That seems fair enough – just what shippers have to do if they don't believe their views have been properly reflected in some modification reports.

It would therefore seem that an independent governance entity managing the modification process, including the chairing of meetings, administration of the consultation process and modification report writing would 'level the playing field' between Transco, DNOs and shippers.

So how would independent management of the modifications process be achieved? One approach might be to create an organisation owned by Transco and DNOs that is run at arms length. Such an organisation could either manage

¹ The actual cost of running the existing network code process is not known to shippers as this data is not published.

the modifications process itself or procure these services from a third party. Another perhaps less satisfactory approach would be for the governance body to simply be an internally separated part of Transco, with the establishment of 'chinese walls' to strictly control communications with other parts of Transco. Perhaps the most 'independent' approach would be to make the governance entity an integral part of the agency business. Such an approach might help facilitate new ownership arrangements for the agency (xoserve) at a future date, (e.g. ownership of the agency by shippers).

Some shippers consider that the issue of independence is of secondary importance provided the deficiencies in the current process (outlined under points 2 to 8) are fully addressed.

2. Recommendations made by Panel rather than Transco.

With the passage of the Energy Bill parties will have a limited right to appeal against the certain modification decisions under the network code, connection and use of system code (CUSC) and the BSC.

Currently recommendations under the network code are made by Transco, and it is probably reasonable to assume appeals will not be allowed where Authority decisions are consistent with such a recommendation. Effectively this means Transco will have full rights of appeal (they are hardly going to recommend to reject their own proposals!), but shippers will be deprived an appeal route where their views are opposed by Transco. Such a position is clearly untenable and perhaps inconsistent with concepts of natural justice.

It is therefore essential that the network code Panel makes modification recommendations. The easiest way of way to manage this would be for the independent governance entity to produce a draft final modification report including all consultation responses and the Panel to make a recommendation on a simple majority vote. The signed-off report (the contents of the report being approved by the Panel) would then be sent to the Authority for consideration. Such business would normally be conducted at regular monthly Panel meetings but on occasions additional ad hoc meetings by telephone may be required from time to time.

3. Panel must represent the diversity of stakeholder views

Extending the role of the Panel to include making recommendations is a significant departure from the Panel's current process management/oversight role. Recommendations and/or decisions made by such a Panel will be of interest to all stakeholders.

Any Panel established in this new environment must therefore reflect the full diversity of shipper and other stakeholder views. Broadly speaking the current election process seems to have produced Panel representatives that reflect a broad balance of interests across the industry, however a different election process may be worth considering if this turns out not to be a widely held view. Any election process must be designed to prevent particular interest groups skewing the industry representation on the Panel. It would for example be very odd not to see a 'big name' domestic supplier employee or indeed a 'big name' producer affiliate employee amongst the Panel members.

4. Panel must not be remote from the industry

Compared to some other industry code panels the current network code Panel members are both involved in the day-to-day modification procedures and are also employed by particular industry stakeholders. As they have a direct interest in the process outcomes they are likely to make robust determinations. Such a Panel can be entrusted to make Panel recommendations. Serious problems could be incurred if the process for election/appointment of Panel members produced a panel that was not really 'in touch' with what is really going on 'on the ground'.

Some parties suggest there might be a role for independent appointees to the Panel. These parties may indeed prove invaluable as a balancing force between Transco/DNOs on the one hand and shippers on the other. Unkind commentators however, might suggest that some of the independent appointees that have served on other industry code panels have had the greatest difficulty in understanding the esoteric nature of modification proposals, and quality of Panel recommendations has suffered as a result.

5. The timetable for assessment of modifications

Other than for urgent modification proposals where we assume Ofgem would dictate the timetable, the schedule for development (assessment) of proposals should be determined by the Panel based on the importance and complexity of the issue being considered. Some minor changes to the current modification rules may be required to place these scheduling matters firmly in the hands of the Panel. The Panel should also be responsible for signing off terms of reference for each modification proposal.

6. Safeguards in place to avoid filibustering or inappropriate 'fast tracking'

A long standing concern of shippers is the opportunities provided within the process for filibustering proposals, particularly by Transco. This has become known as the Transco veto. In effect Transco can vote to prevent a report being sent to the Authority for consideration even though the proposal may have been comprehensively assessed and has widespread support from shippers and other stakeholders. On other occasions Transco also can seek to 'fast track' its proposals through the process without allowing industry participants the opportunity to properly consider matters.

A more robust governance process would not allow particular parties to speed up or delay consideration of particular proposals to suit their own commercial interests.

Any new modification process should define minimum and maximum limits for assessment of non urgent modification proposals. The Panel would normally determine a schedule for each proposal within these boundaries but could set longer assessment periods with the agreement of the Authority.

7. Consistent treatment of modification proposals

The current procedures ensure Transco has the flexibility to amend proposals which it supports. Only Transco can propose alternatives to shipper proposals. This means that without Transco support minor changes to shipper proposals are not permitted even where a feasible alternative is in line with the intent of the

original. This invariably means that only 'fully developed' shipper modifications have a chance of being approved. Although the current process does allow facilitate easy withdrawal and resubmission proposal, vital time can be lost.

It is no longer acceptable to allow discrimination between proposals depending on whether they originate from Transco or a shipper. A process needs to evolve to ensure equivalent treatment if Transco and shipper modification proposals. The way forward may be for each proposer to define the 'defect' the proposal is seeking to address. It would then be open to the proposer to propose an alternative that may emerge in development (assessment) discussions that better addresses that defect. The alternative proposal would go forward to the Panel for consideration.

8. Democratisation of IT decisions impacting agent's central settlement systems

The current UK Link Committee forms part of the network code governance arrangements. It provides a consultative framework in which users of the system can discuss developments and changes to the UK Link suite of systems (including AT link) owned and operated by Transco. Some of the required changes are driven by modification rule changes.

In the light of DN sales the governance arrangements for changes to these settlement systems, which we assume will be owned and managed by the Agent, needs to be reviewed.

Shippers have had a long standing desire to have a greater say in the development of central settlement systems that are critical to their activities as this can ultimately affect the quality of service they can provide to their customers.

A more democratic framework for determining changes to central settlement systems involving Transco, DNOs and shippers managed by the agent/governance entity needs to be established. Users as well as Transco/DNOs should be able to propose (UK link) system modifications.

9. Scope for Panel/Panel Committees to make decisions

Many code related operational decisions are already made by Transco and shippers on a day to day basis. For example the Energy Balancing Committee gives real powers to shippers, to protect the shipping community as a whole against default. Detailed procedures within Transco also interpret how the market rules set out in the network code should be implemented.

It has always proved difficult to draw the line between matters that can be better dealt with by the industry (i.e. through 'self governance') and those matters that should properly be referred to the Authority for a decision. Indeed Ofgem in striving for 'lighter touch regulation' of gas governance Ofgem stated in a consultation on the proposed SPAA in June 2003:

"...every change to the Network Code, no matter how insignificant or patently beneficial, currently requires Ofgem's approval. Whilst this level of regulatory involvement ensures a high degree of accountability, it is perhaps no longer necessary in many instances."

The establishment of a new Panel which is made up of persons that are 'in touch' with the industry and capable of reflecting the full diversity of stakeholder views

and indeed committees overseen by such a Panel could make more decisions without the need to refer matters to the Authority.

The supply point administration agreement (SPAA) divides issues into 'reserved' and 'non reserved' matters. All reserved matters have to be referred to the Authority whilst non reserved matters can be dealt with by a Panel, but with an appeal route to the Authority for parties that are unhappy with the Panel's decision.

Efficiency could perhaps be enhanced further by giving the Panel powers to determine on 'reserved' matters where there is unanimous or a 'substantial majority' (say 80% of those entitled to vote) in favour or against a proposal. This would relieve Ofgem from having to waste its on determinations for straight forward modification proposals that have widespread stakeholder support.

10. Safeguards for delays to Authority decisions

On occasions there are significant delays to Authority decisions. A way of expediting decisions could simply be to allow a Panel recommendation to stand if the Authority fail to make a determination within say [6] months.

Governance of Charging Methodologies

- Centrally managed independent secretariat function.
- Consideration of all changes in a national context.
- No unilateral submission of DN specific charging proposals.

Charging methodologies have traditionally been 'owned' by individual gas transporters, and only transporters have been permitted to propose changes to these methodologies. Assuming this approach continues it is important that charging methodologies are coordinated and consulted on at a national level.

It would seem appropriate for the governance entity to carry out the relevant secretariat functions for Transco and the DNOs. They would administer the consultation processes and centrally maintain charging methodology documents. The governance entity might have a role in writing the final consultation report but actual individual or joint recommendations would probably remain in the hands of Transco/DNOs.

To ensure each DNO cannot unilaterally make changes to its charging structures a new shared approach to co-ordinating or managing changes at a national will be required. Perhaps the best protection against unilateralism would be to establish a charging methodology modification procedure open to DNOs, where individual DNOs would propose changes either at a local level (within area) or nationally (across all DNOs). A joint Transco/DNO Panel would decide whether a proposal would ultimately be submitted to Ofgem. Ofgem would then consider whether or not to veto a proposal.

This approach would minimise the potential for regional differentiation of charging methodologies, however it does mean DNOs can effectively propose out of area changes.

They may be another alternative approach that would address the concern about potential fragmentation within the existing established gas transporter model, (i.e. DNOs can only propose changes to distribution charging methodologies within their own area). The go it alone approach could be allowed, but there

would be a need to mandate other DNOs to in parallel consult and ultimately propose identical changes for their areas. Ofgem will need to have the opportunity to veto or not veto identical changes across all DNs at the same time.

Whatever approach is adopted each DNO charging methodology change will need to be considered in a national context. Consultation reports would summarise the views of shippers but should specifically include each DNOs assessment of both the regional and national implications of any proposed change.

Governance of the Agency

- Flexible enough to allow for new future ownership arrangements².
- Shipper Board members (essential if agent is to be directly funded).

The future corporate governance of the agency (xoserve) business is inevitably dependent on the ownership structure of that business. Nevertheless Shippers and other stakeholders will have a keen great interest in the running of that business because the management of central settlement processes are central to their balancing, settlement and customer facing activities.

Initially it appears that the agent will be jointly owned by Transco and DNOs and indirectly funded through existing/revised price control arrangements. It is these parties that will ultimately have responsibility for running the agency business. Shippers interests will (hopefully) be assured through any newly revitalised (independently run) modification process including having more direct control over changes to central settlement systems.

Any corporate governance arrangements for the agency business or joint Transco/DNO joint ownership agreements with Transco should be flexible enough to allow for new potential ownership arrangements in future (e.g. ownership by shippers) and or establishment of a new licenced entity.

If in future the agency activities are financed through direct funding/service charges on shippers and/or the price control incentives for agency operation on Transco/DNOs removed it will be essential for say [2] shippers to be represented on the agency board.

Under such circumstances shipper directors and other independent directors on the board would be able to scrutinise the expenditure plans of the agency business. We would envisage that shipper directors would be appointed by or from amongst the shipper Panel members.

The matters discussed in this section are essentially about providing proper accountability to stakeholders who ultimately have to pick up the bill for the agency business. Irrespective of the initial funding arrangements for the agency it is probably desirable to establish shipper board members for the agency from day one.

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² Many shippers are not interested in having a financial stake in the agency. They consider the key is to establish more inclusive and democratic governance arrangements which will allow shippers to have a real say over the management of the agency and changes to its processes and systems.

