

# SLR Industry Codes Workgroup Straw Man Report

Paper 03/03, 19 January 2006

## Background

At the second meeting of the Industry Codes Workgroup on 17 November 2005, four straw-men proposals for a revised regulatory regime were identified. These were:

- Model 1. **Ofgem as enforcer of last resort** – Ofgem's role in compliance and enforcement would only be by invitation by the relevant Code's Panel/Committee. It was considered at the time that this may require a change to primary legislation due to difficulties in defining the desired role for Ofgem by changing the licence alone,
- Model 2. **Self-regulation** – this model would be one of self-regulation, with Ofgem's role limited to determining appeals against the conclusions of such self-regulation processes,
- Model 3. **Shipper licence** – SLCs would be changed to mimic the approach used in the gas shipper licence, ie. there would be a general obligation not to prejudice the safe operation of the network, balancing arrangements etc but not an explicit requirement to comply with industry codes, and
- Model 4. **Single condition** – the content of a Licence with regard to Industry Codes would not change but the format by which it is presented would be considerably condensed into, for example, one SLC and an appendix.

At that meeting, EDF and Npower agreed to develop Models 1 and 2 respectively for consideration at the January meeting. Ofgem undertook to expand on the remaining two options.

Following the meeting, EDF and Npower submitted a joint proposal (included on today's agenda as paper 03/01). The following is an assessment of Models 3 and 4 for consideration by the workgroup.

## Model 3 – Shipper licence

### *Description*

Compliance with the Network Codes of gas transporters is not explicitly required by the terms of the gas shipper licence. Condition 3 of that licence states:

1. The licensee shall act in a reasonable and prudent manner in the use it makes of a relevant transporter's pipe-line system for the purpose of the conveyance of gas.

2. Without prejudice to the generality of paragraph 1, the licensee shall not knowingly or recklessly pursue any course of conduct (either alone or with some other person) which is likely to prejudice –
  - (a) the safe and efficient operation, from day to day, by a relevant transporter of its pipe-line system;
  - (b) the safe, economic, and efficient balancing by that transporter of its system; or
  - (c) the due functioning of the arrangements provided for in its Network Code.

Under this model, the obligations to sign or become a party to the various industry codes would remain unchanged. However, the requirement to comply would be rephrased to relate not to adherence with every clause of each industry code but to a more general requirement not to distort the operation of the trading arrangements provided for in the relevant codes and agreements. This obligation could be set out separately for each industry code, in a similar way to the sign and comply obligations currently in the licence, or could alternatively be combined with Model 4 and contained within a single condition for all codes.

#### *Discussion*

This approach may reduce the regulatory risk to participants. At present, any non-compliance with a relevant industry code could theoretically be considered as a breach of licence and enforced as such. Under this proposal, licence enforcement would be subject to a much higher test of demonstrating a significant impact on the operation of the market. While this may already be a consideration in determining the proportionality of Ofgem's potential enforcement of the current licence, this option would formalise such an assessment and prevent Ofgem from deploying regulatory sanctions against low-level or non-material code non-compliances.

Ofgem's key concern in ensuring compliance with agreements such as the BSC can be traced, through the applicable objectives of that code, to the Authority's principal objective of protecting the interests of customers by promoting effective competition. Significant and material non-compliances with the BSC have the potential to impact the ability of that code to facilitate effective competition. This type of model might more closely reflect regulatory concerns about compliance (ie. the trading arrangements should 'work' and deliver competition, rather than every minute detail of the BSC is complied with to the letter).

On the other hand, wording similar to the shipper licence would be more subjective and more open to interpretation as to what constitutes "a course of conduct likely to prejudice the due functioning of the arrangements". This is likely to result in a lack of clarity of Ofgem's role, contrary to the desire expressed by the group, and create uncertainty as to the likelihood and risk of regulatory enforcement action.

This potential lack of clarity may also create difficulties in the enforceability of the obligation.

Views are invited from the group as to the advantages and disadvantages of this approach.

## **Model 4 – Single condition**

### *Description*

This model essentially proposes a formatting change rather than any modification of the effect of the licence obligations. It would create a single licence condition that covered all relevant industry codes rather than the present situation of one condition per code.

### *Discussion*

The intention behind this model is to bring greater clarity to the licence by grouping together all industry code related obligations. It may also help to reduce the size of the supply licence standard conditions.

The obligations for the various codes are not currently consistent. For example, there is an obligation in relation to the CUSC<sup>1</sup> for suppliers to take reasonable steps to secure and implement (without undue delay) changes to that code. There is no such obligation contained within the licence in respect of, for example, the MRA. As another example, SLCs 5 and 6 allow the Authority to relieve the obligations to comply with relevant Grid Codes and Distribution Codes. This is not mirrored in respect of other industry codes. If the industry codes workgroup considers that such obligations should remain, these would need to be reflected in the drafting of the combined licence condition. Where different obligations relate to different industry codes, this may reduce some of the clarity which this option seeks to achieve. This would need to be addressed at the legal drafting stage of the Supply Licence Review.

This model would not in itself make any changes to the nature of the regulations themselves. Concerns about regulatory risk and uncertainty about the potential for regulatory enforcement would not be addressed. However, it should be noted that the intent behind this model could be adopted in conjunction with other models<sup>2</sup>.

Views are invited from the group as to the advantages and disadvantages of this approach.

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<sup>1</sup> SLC 9 para 2

<sup>2</sup> Indeed, the EDF/Npower proposal would achieve the effect of Model 4 in capturing the industry code obligations in a single licence condition.