

Ofgem's Review of the Energy Supply Licence

Compliance with the Industry Codes and Agreements

A paper for the workgroup from EDF Energy

1. Introduction

1.1 The attached draft licence condition has been prepared by EDF Energy following the consideration of a joint EDF Energy / Npower paper at the last meeting of the Industry Codes Workgroup.

1.2 The workgroup thought that it would be helpful to see if the current approach of the gas shipper licence towards licensee compliance with code obligations could work on a wider basis, consistent with the objectives of Ofgem's supply licence review. Under the gas shipper licence, rather than being required to comply with each and every provision of the Network Code, the licensee is required at all times to satisfy certain general requirements in relation to the system.

1.3 The draft condition has therefore been produced for the following purposes:

- to develop the treatment of compliance under the gas shipper licence into a formal generic model;
- to apply that model, and the powers and obligations arising from it, across the whole existing suite of core industry codes and agreements through a single standard licence condition; and
- to amalgamate into that condition a number of other rights and obligations relating to compliance with those documents.

1.4 Gas suppliers are currently required to be a party to, and to comply with, only one core industry document (the Supply Point Administration Agreement). So, for convenience, the condition has been drafted for electricity supply only (where the core documents are more numerous). In principle, however, the draft is equally applicable to gas supply and also, by extension, to other categories of licence.

2. Explanatory notes

2.1 This part of the paper consists of brief explanatory notes on the licence condition. They follow the sequence of the draft and should be read in conjunction with it, but they do not form part of the legal text.

2.2 General: The draft condition reflects two points of good practice for the future drafting of the supply licence:

- most conditions should begin with a clear statement of purpose, and
- where a number of issues are being dealt with in one condition, they should be organised under appropriate headings.

- 2.3 Part A, paragraph 1:** This sets out the purposes of the licence condition. They are: to lay down the licensee's general obligations in relation to the core documents and to make uniform provision for certain compliance and modification matters.
- 2.4 Part B, paragraph 2:** This lists the core industry documents (to be known as 'the relevant instruments') that are covered by the condition.
- 2.5 Part B, paragraph 3:** This requires the licensee to be a party to each of the relevant instruments (except where Ofgem permits otherwise).
- 2.6 Part C:** This sets out the general obligations of the licensee, in relation to each of the relevant instruments, as follows.

Paragraph 4: The licensee's first general obligation is to always act reasonably and prudently in relation to its duties under or pursuant to each instrument.

Paragraph 5: The licensee's second general obligation (phrased as a prohibition) is to refrain from any course of conduct which could undermine the particular objectives or arrangements of a relevant instrument.

Ofgem can at all times secure compliance by the licensee with both of the above obligations through the use of its statutory enforcement functions (which include the power to impose financial penalties).

- 2.7 Part D:** This is designed (i) to allow for compliance with the requirements of a relevant instrument to be principally the responsibility of its governing body, while (ii) enabling that body to certify to Ofgem in certain extreme circumstances that the licensee is in such serious breach of the instrument that Ofgem should treat this as a breach of one of the general obligations, without (iii) fettering Ofgem's enforcement rights and duties at any time.

In detail, the Part D provisions are drafted to work as follows.

Paragraph 6: This provides for Ofgem to treat a finding of 'regulatory breach' by a governing body as conclusive evidence of a contravention by the licensee of one or both of the general obligations imposed by paragraphs 4 and 5, except where Ofgem disagrees with that finding (the assumption being that Ofgem will want to form its own view that such a breach has taken place, and would not merely rely on the governing body's view). The enforcement action that should follow in these circumstances will be entirely a matter for Ofgem.

Paragraph 7: This defines 'regulatory breach' both in substantive terms (that is, the severity of the breach in the opinion of the governing body by reference to the general obligations) and in procedural terms (that is, the breach must have been formally declared as such to both Ofgem and the licensee).

Paragraph 8: This formally preserves the Authority's enforcement powers and duties, regardless of paragraph 6, in relation to the licensee's compliance with the general obligations (and also, for that matter, with the specific obligations imposed under Parts E and G of the condition). This is necessary so that there can be no presumption that the only circumstances in which Ofgem can enforce compliance with the general obligations are the paragraph 6 circumstances.

- 2.8 Part E, paragraphs 9 and 10:** These ensure that where the modification of a relevant instrument has knock-on effects for other relevant instruments, the licensee must do whatever it reasonably can, in accordance with the applicable procedures, to secure the necessary consequential modifications. This duty already exists under some (but not all) licence conditions relating to the core industry documents, and clearly would need to be incorporated into a single licence condition of the kind now proposed.
- 2.9 Part E, paragraph 11:** This preserves the supremacy of any relevant rights of Ofgem (or the Secretary of State) in relation to consequential modifications of the kind mentioned above.
- 2.10 Part F, paragraphs 12 and 13:** These (as in some but not all of the existing licence conditions relating to core documents) enable Ofgem to issue limited or more general derogations for a particular licensee in relation to any relevant instrument, subject to a simple consultative procedure.
- 2.11 Part G, paragraph 14:** Subject always to reasonableness, this enables Ofgem to require the licensee to provide information concerning its compliance with any core document or the licence condition itself.

3. Conclusions

- 3.1** The compliance model set forth in the joint paper discussed at the workgroup's last meeting had Ofgem acting as the enforcer of last resort at the request of the industry, but not otherwise, and only in respect of certain predetermined matters in the core industry documents. This was seen as likely to be sub-optimal in at least two key respects:
- it would be extremely difficult to reach agreement on the predetermined matters across all of the industry documents, and
 - it was not possible to exclude Ofgem's intervention from certain matters anyway, since all provisions of an industry document are potentially of regulatory interest and concern.
- 3.2** EDF Energy considers that the alternative model represented by the attached draft licence condition is not open to such criticisms and also has the merit of adapting, and building upon, an existing licence precedent. The model is not only attractive in principle, but has a strong pragmatic basis.
- 3.3** EDF Energy invites the workgroup to adopt this model as the optimal way forward in respect of licensee compliance with the core industry codes and agreements under the supply licence review.

Condition XX: General Obligations in Relation to Relevant Instruments

Part A: This condition

1. The purposes of this condition are:
 - (a) to set out the general obligations of the licensee in relation to certain industry codes and agreements to which the licensee must be a party; and
 - (b) to provide on a uniform basis for certain matters relating to compliance with those codes and agreements and to modifications of them.

Part B: The relevant instruments

2. The codes and agreements (each being a 'relevant instrument' under this condition) to which paragraph 1 refers are:
 - (a) the Balancing and Settlement Code;
 - (b) the Connection and Use of System Code;
 - (c) the Distribution Code;
 - (d) the Distribution Connection and Use of System Agreement;
 - (e) the Grid Code; and
 - (f) the Master Registration Agreement,

in each case as from time to time modified or replaced, and insofar as applicable to the licensee.
3. Unless and to the extent that the Authority consents otherwise, the licensee must be a party to each of the relevant instruments.

Part C: General obligations of licensee

4. The licensee must at all times act in a reasonable and prudent manner in relation to the obligations and requirements placed on it by a relevant instrument or which arise under or pursuant to the provisions of that instrument.
5. Without prejudice to the generality of paragraph 4, the licensee must not (either alone or with some other person) pursue any course of conduct in relation to a relevant instrument which is likely to prejudice achievement of the objectives applicable to that instrument or the due functioning of the arrangements for which it provides.

Part D: Presumption of non-compliance

6. A finding by the body responsible for the governance of a relevant instrument ('the governing body') that the licensee is or has been in regulatory breach of that instrument may be treated by the Authority, unless the Authority determines otherwise, as conclusive of the fact that the licensee is contravening or has contravened paragraph 4 or 5 (or both) of this condition.
7. For the purposes of paragraph 6, 'regulatory breach', in relation to a relevant instrument, means an infringement of an obligation or requirement imposed, or a ruling given, under any provision of that instrument which:
 - (a) in the opinion of the governing body is so serious (whether by reason of its materiality, persistence, or otherwise) as to amount to a contravention of paragraph 4 or 5 (or both) of this condition; and
 - (b) has been declared as such by the governing body, in accordance with the appropriate provisions of the relevant instrument, by notice given to both the Authority and the licensee.
8. Paragraph 6 is without prejudice to the Authority's exercise of its enforcement functions under the Act in relation to compliance with this condition in circumstances other than those contemplated by that paragraph.

Part E: Consequential changes

9. This paragraph applies where a relevant instrument under or in relation to which the licensee holds rights of amendment requires to be modified (a 'consequential change') in order to give full and timely effect to the modification of another relevant instrument.
10. Where paragraph 9 applies, the licensee must, in accordance with such procedures as are applicable under or in relation to the relevant instrument to which the consequential change applies, take all reasonable steps to secure and implement that change and not take any steps to prevent or unduly delay it.
11. Paragraph 10 is without prejudice to any rights of approval, veto, or direction which the Authority or the Secretary of State may have in respect of proposed changes to relevant instruments.

Part F: Derogations

12. The Authority may issue a direction relieving the licensee of its obligations under a relevant instrument in respect of such parts of that instrument and to such extent and subject to such conditions as may be specified in the direction.
13. Before exercising its power under paragraph 12, the Authority must have consulted the licensee, the governing body of the relevant instrument, and such authorised electricity operators (if any) as appear to the Authority to be likely to be affected thereby.

Part G: Information

14. The licensee must provide the Authority with such information, in such manner and at such times, as the Authority may reasonably request in connection with the licensee's compliance with any relevant instrument or this condition.

Note: On a rough estimate, the above draft condition would have the effect of shortening the current electricity supply licence by about 20 pages.