

# Joint Office Of Gas Transporters

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Dear Mark,

## **REVIEW OF INDUSTRY CODE GOVERNANCE**

This response to the 28<sup>th</sup> November open letter on a review of Code Governance is being submitted by the Joint Office (JO) as the administrator of the UNC Modification Process. The views expressed are therefore those of the Joint Office and may differ from those of the Gas Transporters on whose behalf the JO operates.

The JO is supportive of a review of code governance which seeks to identify and establish best practice. We are also supportive of this review being conducted by Ofgem, being ideally positioned to take a view across all of the various energy industry codes. However, we would urge Ofgem to focus on reforms within its own remit, such as Licence changes, rather than seeking to drive industry change. The rules which establish governance processes are themselves open to modification and we believe that it is preferable for modifications to these rules to be market driven. If, for example, gas Shippers believe that the UNC Modification Rules are less effective than those in the BSC, they are able to raise a Modification Proposal seeking to introduce the BSC procedures into the UNC. Equally incremental change can be proposed where market participants identify that this is appropriate. By contrast, if a single, one size fits all, governance process were to be imposed on all codes, there would be a risk that code specific issues would not be taken into account and that innovation and subsequent development of both the governance process and the codes themselves could be stifled.

Against this background, we would support Ofgem establishing measures of effectiveness of the existing code governance processes. These would seek, for example, to look at variations in the level of costs faced by industry participants under each of the governance processes; the extent of participation in the governance processes; perceptions of the quality of the processes as they presently operate; and measures of outputs from the various governance processes. In the case of the UNC, we would suggest that the volume of modification activity, with on average six Modification Proposals having been raised per month, is a clear indicator that the present process is not acting as a barrier to change. As such, care should be taken to ensure that positive features of the present UNC governance process are not lost.

The remainder of this response follows the structure and headings in your open letter.

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## *Is it time to look again at the effectiveness of code governance?*

The JO was a novel concept when introduced in May 2005, and a review after approaching three years of operation would seem appropriate. However, we would observe that if there were specific concerns about the way in which the UNC governance process has operated, we would expect this to have been reflected in the raising of UNC Modification Proposals. That no Proposals for significant change to the Modification Rules are on the table perhaps suggests that the gas industry believes there are higher priorities at the present time.

We are not in a position to comment on timeliness with respect to other codes.

## *Critical analysis of modification proposals*

We note in the open letter that “Of major concern is the quality and depth of analysis provided to us in code modification reports and the extent to which arguments in support of code modifications (or for the retention of the status quo) are well substantiated.” While we appreciate that this may be a major concern for Ofgem in some specific cases, the fact that numerous UNC Modification Proposals have been progressed and implemented suggests to us that this is not a general problem and that the industry is satisfied that sufficient analysis is generated for individual parties to express their views on specific Proposals. The JO would be concerned if the governance processes were amended such that specific analyses were mandatory in all cases. We believe the level of analysis should be proportionate to the Proposal under consideration and, as such, flexibility in the governance arrangements is desirable.

More generally, from the perspective of a code administrator, the JO would argue that it is not the role of the governance process *per se* to generate analysis of Modification Proposals. We would characterise an efficient governance process as facilitating and reporting, as opposed to generating, analysis. That is, it is appropriate for the governance process to establish questions which participants may wish to address when considering and developing Proposals, and for the process to subsequently capture the information which participants choose to provide. This approach allows the market to establish the level of resources which should be devoted to a particular Proposal rather than the level of analysis being mandated. If, however, Ofgem believe that further analysis is required to support decisions as to whether or not to direct implementation of a specific Proposal, the JO would suggest three routes are open to Ofgem, none of which require a change to the existing UNC governance process.

First, Ofgem involvement at the early stages of a Proposal's development provides an opportunity for the Regulator to indicate any issues which it believes should be addressed as part of the consideration of that Proposal. We would expect the industry to respond positively to any such guidance, and would see this as preferable to Ofgem identifying issues only after a Proposal is sent to it for decision. For example, UNC Modification Proposal 0088, which is referred to in the open letter as an example of where more robust analysis would have been helpful, was considered by a Development Workgroup from

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July to November 2006, with Ofgem representatives present at all six Workgroup meetings. However, it was not until May 2007 that Ofgem provided a note, "Issues for further consideration by 088 Development Workgroup", seeking additional information. With the benefit of hindsight, we would suggest that the Final Modification Report would have been more robust if Ofgem had been able to provide this note prior to rather than after completion of the Report.

Second, Ofgem can and does undertake Impact Assessments where appropriate to do so. We do not believe it would be appropriate for the code governance processes to replace these Impact Assessments which are able to take into account factors which may go beyond the remit of a particular code.

Third, Ofgem could immediately reject Proposals which are not supported by sufficiently robust analysis. While this may create some short term loss of benefits through the rejection of Proposals implementation of which would in fact further the achievement of relevant objectives, we would expect the industry to respond quickly to the signal of the need for more robust analysis such that in the medium and long term there would be benefits through the presentation of more robust reports which would assist Ofgem in taking timely and appropriate decisions.

The JO would suggest that adopting the three steps above as and when appropriate should address Ofgem's concerns without a need to amend the existing UNC governance process. We also note in the open letter the view that "The need to ensure that the Authority's decisions are based on clear and transparent reasoning and robust analysis has been further emphasised by the recent decision of the Competition Commission on the appeal of the Authority's decisions on the gas offtake modification proposals. The Authority may only be able to meet the high standards required of it if the code modification reports themselves demonstrate well argued and effective analysis." We would again not see this concern as necessarily indicating that the underlying UNC governance processes are in need of reform. In this particular case the development work and analysis were undertaken through an Ofgem lead process rather than through the UNC governance process. To inform this and contribute to the debate, the industry commissioned an independent report considering the potential costs and benefits of the reforms under consideration. This was in addition to Ofgem's own Impact Assessment, which was extensively consulted on and developed to reflect the best available information, including that within the industry commissioned report. We do not, therefore, believe that this example necessarily indicates that the UNC governance process is in need of reform on the grounds that the Final Modification Reports did not contain well argued and effective analysis. Rather we are concerned that there would have been unnecessary duplication if the Modification Reports had incorporated within them the full text of the independent cost benefit analysis, or if they had been subsequently expanded to include Ofgem's final Impact Assessment. The JO would suggest that the underlying concern relates to the quality of the analysis and its interpretation rather than the underpinning governance process.

In terms of identifying Modification Proposals where Ofgem believe substantive analysis is likely to be necessary to support decisions, there is nothing in the existing UNC governance process which prevents these being identified at an early stage. For example, when a new Proposal is presented to the Modification Panel, discussions can include consideration of the analysis which is likely to be required, with input from the Ofgem Panel representative potentially playing a key role. If Ofgem would wish to be given the opportunity to debate with the Modification Panel the analysis which is likely to be justified for each Modification Proposal, this could be adopted immediately rather than awaiting completion of the Review. However, the Review could usefully address how any resulting analysis would best be commissioned, managed and financed.

In addition, the Review might consider whether a more holistic approach to analysis is desirable. The gas offtakes proposals provide a potential case study as to whether parties believe the outcome would have been different if all aspects of the changes envisaged had been progressed under a single rather than multiple governance processes and, if so, what form such a process could take in the future. For example, it may be appropriate for the Ofgem Impact Assessment, or a similar exercise, to be at the centre of a revised governance process when multiple codes and/or Licence documents are subject to change rather than just a change to a single code.

### *The relevance of code objectives – are they still fit for purpose?*

The JO would support a review of the code objectives. While it has proved possible for all UNC Modification Proposals to be assessed against the existing relevant objectives, there is a tendency for this to be the result of shaping the description of impacts to fit within the wording of a particular relevant objective rather than a full explanation of the impact on each relevant objective. We therefore believe there would be merit in developing explanations of exactly what is meant by each relevant objective and emphasising in the governance process the desirability of clearly demonstrating how behaviours would be changed such that the achievement of any relevant objective would be impacted. We would expect that any such explanation of the underpinnings of the relevant objectives would help to clarify whether or not the existing objectives remain fit for purpose or if any amendment or extension is merited.

### *Charging Methodologies*

We note the possibility in the open letter of “transferring the methodologies into the industry codes and ensuring that they are governed by independent code administrators.” While the JO has no particular view on the desirability or otherwise of this option, we would suggest that if this is deemed appropriate for charging methodologies, consideration should also be given to other methodologies and statements that are presently subject to governance rules established within Licences. We would also observe that there would be a resource implication for the code administrators if this option were to be adopted, with the scale of the implication depending on the number of documents brought within a revised governance framework. However, the JO already supports the Transporter change process in terms of chairing meetings

and publishing consultation and other documents, and would be willing to expand this role if that were proposed.

## Other issues

- Issues relating to fragmented code administration and the multiplicity of code administrators, including

- How this impacts on the assessment of cross-code issues

The JO believes that any impacts on the assessment of cross-code issues are primarily the result of fragmented codes rather than fragmented code administration. That said, difficulties can arise when UNC Modification Proposals are linked to Licence obligations rather than other codes. These are generally dealt with pragmatically by the Modification Panel ensuring that UNC consultation periods are aligned with those established through Licences, and by implementation timetables being aligned.

As a new code, experience with the iGT UNC is relatively limited. However, a number of similarly worded Modification and Review Proposals have been raised seeking to achieve the same market change under each gas UNC. We believe the Review could usefully consider whether it is appropriate for a common governance process to be adopted for such Proposals, and how that would be best managed and funded.

- Whether this results in duplicated or conflicting governance in some areas

The JO is not aware of any duplicated or conflicting governance as a result of fragmented code administration as opposed to fragmented codes.

- Efficiency incentives and cost controls on code administrators

The JO is funded through price controlled revenues and, as such, faces the same strong efficiency incentives as the gas network owners.

In principle a multiplicity of code administrators is potentially advantageous for efficiency in that it allows for benchmarking and comparative or actual competition. However, it is potentially disadvantageous to the extent that economies of scale and scope are not realised. The Review could usefully analyse the relative importance of each of these and assess which approach is most likely to operate in consumers' interests.

- Whether the proliferation of code administrators is desirable or should some of these functions be merged

The JO is not in a position to judge this at present. However, we would cooperate fully with the gathering of evidence to support analysis which could be used to inform judgements regarding the costs and benefits of any mergers of functions.

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- Whether code administrators need to be independent of market participants;

We believe that being seen not to favour any particular market participant is an important attribute of any code administrator. However, being independent of market participants is neither a necessary nor sufficient condition to achieve this. The JO believes that a more important factor is the governance regime and the establishment of rules which must be followed by all parties. The rules which govern the process can be written to deliver non-discrimination and the necessary transparency which helps to assure all parties that no undue discrimination is occurring. We believe the JO has been especially successful in this respect, being seen to operate the UNC governance process neutrally despite being 100% dependent on the gas networks. Indeed the JO can confirm that the networks have never made any attempt to exert undue influence on the way in which the governance process is operated by the JO.

- Whether there is scope for more self-regulation within the codes;

The JO believes consideration should be given to increasing self-governance within the UNC. This could take the form of governance such as is already established for a number of ancillary documents whereby change can be made provided this is approved by the Uniform Network Code Committee. Consideration might also be given to all Modification Proposals, subject to safeguards, being implemented or otherwise solely on the basis of a Modification Panel recommendation. The safeguards might take the form of a (limited) right of appeal to Ofgem whose view would take precedence over that of the Modification Panel. Also provision could be made for Ofgem to reserve the right to take an implementation decision itself in the case of any particular Modification Proposal.

- Whether the structure of code Panels and other committees is appropriate;

The JO is not in a position to judge the impact of differing structures. However, we would cooperate fully with the gathering of evidence to support analysis which could be used to inform judgements regarding the costs and benefits of the existing approaches under various codes.

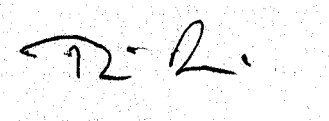
- Whether there are deficiencies surrounding the provision and quality of legal text.

The JO is aware that there have been some issues surrounding the quality of legal text provided in support of UNC Modification Proposals. However, steps have been taken to remedy this and we do not believe there is a fundamental problem with the governance regime which impacts this area.

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We hope that this response is helpful and look forward to further involvement in the Review.

Yours Sincerely,

A handwritten signature in black ink, appearing to read 'T. Davis', is placed over a rectangular area of the document that has been redacted with a light gray stippled pattern.

Tim Davis  
Chief Executive