



Industry Participants, Customers
and other interested parties

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Dear Colleague,

Codes governance review - Update

On 28 November we initiated a review of the industry codes governance arrangements ('the governance review') and consulted upon a number of issues and areas of concern which we considered would be worthy of consideration as part of the review. The consultation on our open letter closed on 22 January.¹

We also held a Powering the Energy Debate (PED) event on 28 February, where we received presentations from a number of speakers from different sectors within the industry outlining their perspectives on the governance arrangements.²

The purpose of the event, along with the consultation responses, is to assist Ofgem in determining the scope of the governance review.

We have also appointed consultants from the Brattle Group and the law firm, Simmons and Simmons, to undertake an independent critique of the codes governance arrangements. This critique is intended to inform the scope of the governance review.

The purpose of this letter is to set out in broad terms the scope of the work that Brattle and Simmons and Simmons ('the consultants') will be undertaking and to provide an update on our timetable.

Independent critique – scope of work

The consultants will be undertaking work across a number of areas, drawing largely on the issues that have been identified by Ofgem in its open letter and through the consultation process. The areas to be covered in the critique include:

- **Accessibility and transparency.** Whether the codes regime is inaccessible to new entrants and if so, what can be done to address any concerns which the consultants have identified?

¹ Copies of the responses to the consultation can be found on Ofgem's website at <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=3&refer=Licensing/IndCodes/CGR>

² A copy of the presentations for this event can be found on Ofgem's website at <http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Pages/GCR.aspx>

- **The quality of analysis in code modification reports.** The consultants have been asked to review the quality of analysis across a number of modifications (having particular regard to the quality of the modification reports) and, where relevant, identify options for improving quality. As part of this process, the consultants will be reviewing the modification reports and processes for a number of proposals across the three major commercial codes, namely CUSC, BSC and UNC. The proposals that form the subject of the audit will be:

BSC modifications

P136 - *Marginal definition of the "main" Energy Imbalance Price*

P137 – *Revised calculation of System Buy Price and System Sell Price*

P213 - *Facilitating micro-generation (Optional Single MPAN)*

UNC modifications

149/149A - *Gas Emergency Cashout Arrangements: Keeping the On the Day Commodity Market open during a Gas Deficit Emergency*

156/156A/169/169A - *Transfer and trading of capacity between ASEPs*

88 – *Extension of DM service to enable Consumer Demand Side Management*

CUSC modifications

CAP 047 - *Competitive Process for Mandatory Frequency Response*

CAP 158 - *Provision of interim response volume information*

- **Comparison of modification rules and processes.** The consultants will undertake a comparison of rules and processes across the major codes (CUSC, BSC and UNC) to identify those processes that work well and those that do not. In undertaking this review, the consultants will draw upon and identify procedures from the other codes (eg DCUSA, MRA) that work well and could be applied to the major codes. Amongst other things the consultants will consider issues including:
 - Prioritisation of modification proposals and issues
 - Definition, development and assessment processes
 - Treatment and consideration of alternative modification proposals
 - Panel composition
 - Customer representation
- **Accountability of code administrators.** The consultants will explore whether the code administrators for the three major codes are sufficiently accountable in terms of their costs and quality of service. The consultants will consider options for increasing accountability where this is relevant.
- **Fragmentation of electricity code arrangements.** The consultants will explore whether the fragmentation of the electricity code arrangements creates costs or barriers to entry, and if so, will consider options for reducing the degree of fragmentation.
- **Self governance.** The consultants will consider the costs/benefits and risks of increasing self governance within the codes framework.

- **Charging methodologies.** The consultants will explore the advantages/disadvantages of making charging methodologies more accessible (e.g. in terms of change processes) to industry participants.
- **Code objectives.** The consultants will consider and comment upon the issue of alignment of code objectives with the Authority's duties.

In undertaking their work, we have also asked the consultants to conduct **specific case studies** on the operation of the governance arrangements in two major strategic areas. These case studies will cover the processes associated with:

- **Electricity cash out reform** (including modifications P211³, P212⁴ and P217⁵)
- **Electricity transmission access reform** (including modifications CAP 131⁶, CAP 148⁷ and other related transmission access reform proposals)

In performing these case studies, the consultants will address whether the codes governance framework is failing to deliver policy reform in these areas and if so, what improvements could be made to the governance arrangements.

Questionnaire

In order to assist the consultants in undertaking this analysis, they have published a questionnaire that covers some of the issues outlined above in relation to the codes.

The questionnaire is being published today at <http://www.brattle.com/survey> and the closing date for receiving completed questionnaires is 14 April 2008. Please note that it is possible to submit a response to this questionnaire that will be kept confidential from Ofgem.

Way forward

As outlined above, the purpose of the consultants work is to help inform the scope of the governance review. This work is due to be completed in May 2008 following which a report will be submitted to Ofgem.

Following the completion of this work, Ofgem intends to issue its conclusions on the scope of the governance review in June 2008. As noted above, Ofgem's conclusions will be informed by the responses to the November open letter consultation, the consultants critique and views expressed at the February PED event.

If you have any questions regarding this letter please contact me on the above number.

Yours sincerely



Mark Feather
Director, Industry Codes and Licensing

³ P211 – Main imbalance price based on ex-post unconstrained schedule

⁴ P212 – Main imbalance price based on market reference price

⁵ P217 – Revised tagging process and calculation of cash out prices

⁶ CAP 131 – User Commitment for New and Existing Generators

⁷ CAP 148 – Deemed access rights to the GB transmission system for renewable generators