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Dear Mark

### **Proposed Guidance - Environmental Issues and the Code Objectives**

We are writing to you with regard to the proposed guidance set out in your open letter of 15 April 2008. We are concerned that this guidance appears to have been presented as a formal requirement of Panels and could pre-empt key conclusions of the Code Governance Review which is still at an early stage. In particular the guidance note appears to assume that the modification procedures under the various codes already require cost-benefit analysis and then goes on to say how any environmental impact of greenhouse gas emissions might be quantified. In addition it appears that Ofgem wish to place greater emphasis on the views of Panels and the analysis conducted by modification groups rather than individual consultation responses – this appears to be a change.

We agree that any environmental or sustainability matters should logically be considered as part of any code 'efficiency objective' and it is generally within the gift of code administrators and Panels to seek to present or consider arguments in this way. Furthermore we agree that alignment of industry code and Ofgem objectives is desirable, but that we also consider that any changes should be implemented carefully and formally to avoid risking distorting the code modification decision making process – hence we were under the impression that full implications of such changes would be considered as part of the wider ongoing Industry Code Governance Review.

Formal cost-benefit analysis does not form part of industry code modification procedures and where quantitative analysis is carried out (this is the exception rather than the rule) it is typically based on information volunteered by code signatories or in some instances by the code administrator where they have access to relevant data. Workgroups carefully consider arguments for and against a proposal, verify any evidence presented to them and suggest viable alternatives where appropriate. In many cases it will not be feasible to apply the guidance suggested by Ofgem in a meaningful way.

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At the recent Powering the Energy Debate seminar E.ON UK stressed the importance of ensuring the code governance processes 'filter-out' proposals that are little more than special pleading favouring particular parties or interest groups. For example access to the grid for renewable generators in Scotland is a particularly emotive and political issue at the moment and we are keen to ensure that key modification recommendations do not give undue weight to such special pleading.

Like Ofgem we want to ensure that the modification process can adequately assess proposals in terms of long-term economic efficiency including those that arise from environmental considerations (this is nothing new). We do not however, want a skewed process that ends up providing cross-subsidies to particular classes of users simply because of a flawed assessment of carbon or other environmental costs.

In many cases we agree that the valuation of carbon (or its equivalent) could offer a means of objectively quantifying the impact of greenhouse gas emissions, but only where this has not already been taken into account through other market mechanisms. For example the benefit of low carbon generation is already signalled though CCL, EUETS and the RO. We therefore think that there should be a careful consideration of the potential for double-counting of environmental benefits and costs, when Panels seek to undertake cost benefit analysis in this manner. This is in line with DEFRA's guidance on this issue which requires only the incremental costs and benefits associated with a policy decision to be assessed.

We understand that Ofgem may feel it needs to provide guidance on this issue now and to the extent that this represents advice on how Ofgem would undertake such analysis it is very helpful in assisting the Panels' deliberations. However, as there is no formal governance that provides for the contents of the letter to be imposed on parties, we were a little unclear as to why it stated that Panels should take account of this guidance from 19 May 2008. We consider it would be helpful to undertake a more detailed consideration of Ofgem's proposed guidance as part of the wider Code Governance Review. In the meantime interested parties can continue to outline their views on the environmental costs and benefits of proposals in their responses and in code working groups, so that such analysis can be reflected in final modification reports to inform both Panel recommendations and Ofgem decisions.

We would appreciate being involved in how best to progress this important issue. Please feel free to give me a call if you wish to discuss our concerns further.

Yours sincerely,

Peter Bolitho  
Trading Arrangements Manager