



Industry participants, customers
and other interested parties

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value for all customers*

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Dear Colleague,

Review of Industry Code Governance – Environment and Code Objectives

In June 2008 we published our decision on the scope of the Review of Industry Code Governance (the "Review"). In the Review decision document (the "June document") we indicated that one aspect of the Review would involve our consulting on whether panels and industry should have wider responsibilities to assess environmental impacts. This letter consults on these issues.

Background

In the June document the Authority indicated that it does not believe there is merit in consulting on aligning all of its statutory duties or its principal objective to the code objectives. However, the Authority indicated it would give further consideration to whether code panels and industry should have wider responsibilities to assess environmental impacts as part of the development and assessment framework for code modification proposals such that the industry's assessment would be further aligned with the Authority's assessment.

In terms of specific measures, the Authority indicated it would explore whether to expand the scope of the existing code objectives or alternatively introduce a new general environmental objective which may encompass more than an assessment of Green House Gas ("GHG") impacts. The Authority also indicated it would explore more light handed measures including a requirement on code panels to consult on environmental issues in the context of code modification proposals.

The treatment of environmental issues under the current arrangements

Under the existing codes arrangements, the industry and panels can assess and take into account impacts on GHG emissions against the relevant code objective governing efficient and economic network operation. Ofgem's view on the treatment of GHG emissions under the existing code arrangements was set out in its Final Clarification and Guidance ("the Guidance") on the treatment of GHG emissions which was issued in June 2008.¹

¹ The Guidance issued in June 2008 applies to the Balancing and Settlement Code, the Connection and Use of System Code, the Uniform Network Code, the Distribution Connection and Use of System Agreement, the System Operator Transmission Owner Code, the Uniform Network Code for Independent Gas Transporters, the Grid Code and the Distribution Code.

In addition, there are wider impacts on the environment beyond the costs of GHG emissions that may need to be assessed by code panels and industry under the existing framework. For example, in the case of Connection and Use of System Code ("CUSC") modification proposals, panels and industry would need to consider, where relevant, the extent to which a proposal impacts on the discharge of National Grid's duties relating to the environment under Schedule 9 of the Electricity Act.

Key issues for consultation

The questions which this consultation considers are:

1. whether Ofgem should introduce express requirements on code panels and industry to consider GHG issues; and
2. whether Ofgem should introduce express requirements on code panels and industry to consider broader environmental issues in addition to GHG impacts.

Green house gas emissions

As we made clear in the Guidance, we consider that industry should already be assessing and taking into account the impacts on GHG emissions which a particular code modification proposal, if implemented, would have or be likely to have. This is on the basis that it is now possible to take account of the economic costs of GHG emissions (and the benefits of reductions in GHG emissions) in the same way that Ofgem, the code panels and industry would consider other economic costs and benefits when assessing a modification against the relevant code objective governing efficient and economic network operation.

Since the Guidance was published in June 2008, industry participants have launched initiatives to progress its implementation. In particular, the CUSC Amendment Panel has established the Environmental Standing Group to consider the implications of the Guidance for CUSC amendment proposals. Given the cross code nature of the Guidance, the CUSC Panel invited other code panels to participate in the standing group with a view to establishing a consistent approach to carbon costing across industry.

The group has issued an interim report² concluding amongst other things that the assessment of carbon costs envisaged by Ofgem as part of the change assessment process is achievable under the CUSC process. The group intends to issue its final report shortly, which will include its conclusions, guidance and any recommendations.

Does the existing framework require the assessment of GHG impacts?

Whilst Ofgem has been encouraged by the work of the industry and panels in implementing the Guidance, we also recognise that we received a number of responses to our April 2008 consultation on the Guidance which indicated Ofgem should consider formally amending the existing framework (for example, the code objectives) to provide greater clarity to industry and panels on the consideration of environmental issues.

A key issue therefore is whether it is accepted that the existing legal framework not only enables but requires industry and code panels to assess and take account of the impacts of modification proposals on GHG emissions or whether Ofgem should progress licence modifications to put the position beyond doubt.

It is our view that not only *can* the industry assess GHG emissions, but that it *should* be doing so under the existing legal framework. Now that a financial value can be placed on GHG emissions, the economic costs and benefits should be taken into account in the same way as other costs and benefits, when assessing a modification

² A copy of the report can be found on National Grid's website [here](#).

proposal against the relevant code objective governing economic and efficient network operation.

However, we are interested in the views of respondents on this issue and, depending on the consultation responses we receive, we may need to consider introducing new licence provisions to expressly require that GHG impacts are assessed by industry and panels in considering code modification proposals.

The scope of the assessment

The other issue to consider in deciding whether any changes to relevant licences are required is the scope of the assessment which industry can and should do under the existing framework. Questions have been raised by industry participants as to whether an assessment of GHG impacts undertaken within the context of the existing framework should be limited to assessing the impact on a particular licensee, the industry as a whole or society at large.

We consider that if a modification proposal is raised then, where relevant, the quantifiable impacts of the proposal on GHG emissions should be considered in the assessment process. **We do not consider that the environmental impacts must relate to the licensee for the impacts to be relevant and therefore assessed.** The assessment under the efficient and economic operation objective must, therefore, seek to measure any impact on GHG emissions of the implementation of the code modification.

We consider this is the position under the existing framework and depending on the consultation responses we receive, we may need to consider introducing new licence provisions to ensure that there is clarity on this issue.

Summary

In summary, we would welcome industry and panel views on whether they agree that the existing code framework not only enables, but also obliges them to assess the GHG impacts of code modification proposals under the existing code objective governing efficient and economic network operation and that the scope for this assessment is not limited to the impact on a particular licensee or industry.

Consideration of broader environmental issues

As indicated above, there are some limited circumstances in which industry might, as part of the code modification assessment process be required, by the existing framework, to assess and take account of impacts on the environment other than GHG impacts. For example, schedule 9 of the Electricity Act contains certain duties relating to the environment which are applicable to NGET. These duties are picked up in the relevant objectives of the CUSC. However, the requirements to assess these broader impacts do not extend beyond CUSC.

In general, therefore, industry does not assess or take account of broader environmental impacts, such as impacts on visual amenity, local air quality, the natural landscape, noise pollution and flora and fauna, when developing and assessing code modification proposals.

A question for this consultation is whether additional requirements should be placed on code panels and industry to assess these broader environmental issues. We consider below some of the potential upsides and downsides of requiring industry to assess and take account of broader environmental impacts.

Alignment of Authority and industry considerations

A potential advantage to better aligning the industry's and code panels' assessment framework with the Authority's decision-making framework is that it would allow industry

participants to provide their views on the broader environmental impacts of a modification proposal as part of the final report on the modification provided to the Authority, thereby potentially better facilitating the Authority's ability to take account of those views in making its decision.

Inclusivity, accessibility and transparency benefits

Extending the governance arrangements to allow code panel and industry participants to consider and present their views on wider environmental issues during the modification proposal development process might improve inclusivity, accessibility and transparency.

Public policy issues and industry expertise

We have already indicated that the introduction of the shadow cost of carbon and the EU ETS means that a financial value can be attributed to GHG emissions impacts. We would welcome your views on the ways in which code panels and industry participants could take into account impacts on visual amenity, local air quality, landscape, noise pollution or flora or fauna. We consider that in the context of code modifications, such impacts are more likely to be measured using judgements, including considerations of public policy and public interest, rather than through using clear and quantifiable processes.

Proportionality

We would not expect there to be many code modifications that are likely to have direct impacts on visual amenity, noise pollution, local air quality, the landscape or flora and fauna. Where there are, the planning framework should help ensure that broader environmental issues are assessed and consulted on. As such, it will be important to consider whether it would be proportionate to introduce requirements on code panels and industry participant to consider these issues.

In particular we need to have regard to our better regulation duty under the Electricity and Gas Acts which requires us to ensure that regulatory activities are transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed. We also need to have regard to our duty under the Regulatory Enforcement and Sanctions Act 2008 which requires that we do not impose any unnecessary burdens.

Questions for respondents

We would welcome your views on the issues outlined in this open letter. In particular we would welcome your views on:

1. our position that the existing legal framework is sufficient not only to enable but also to require industry and code panels to assess and take account of the impacts of modification proposals on GHG emissions;
2. our position that the scope of the assessment required by the existing legal framework is not limited to the impact on a particular licensee or industry;
3. whether you consider that there would be merit in amending relevant licence conditions with a view to expressly providing for industry and code panels to have regard to the economic impacts of GHG emissions in considering modification proposals;
4. our interpretation of what constitutes "broader environmental issues" and whether there are additional environmental considerations to those that are captured within this letter which industry and panels could take account of; and

5. whether industry and code panels should take account of broader environmental impacts when considering code modification proposals and, if so, how industry and code panels could take account of those impacts.

We request that responses to this consultation be sent to Dipen.gadhia@ofgem.gov.uk. Responses should be submitted no later than 16 January 2008.

Next Steps

Following the receipt of responses to this consultation, we will determine whether to confirm our provisional views or, depending on the nature of the responses received, give further consideration to whether licence amendments should be proposed in this area.

If you would like to discuss any of the issues in this open letter, please call Dipen Gadhia on 0207 901 7168 or email: Dipen.Gadhia@ofgem.gov.uk.

Yours sincerely



Mark Feather
Director, Industry Codes and Licensing