



Gas and Electricity industry participants, consumer representatives, code administrators and other interested parties.

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Dear Colleague

## **The “timing-out” of Authority decisions on modification proposals**

### ***Background***

On 17 July 2008 we published a letter (the “July Implications Letter”<sup>1</sup>) setting out that the Authority would not be in a position to reach a decision in relation to six outstanding proposals<sup>2</sup> to alter the rules within the Balancing and Settlement Code (the “BSC”) that govern how transmission losses are allocated to users of the electricity transmission system (the “Losses Proposals”).

The Authority had deferred making a decision on these proposals in September 2007 in order to conduct a further review of the analysis provided by Oxa during the industry assessment process<sup>3</sup>. The delay introduced by this additional review meant that the Authority could not reach a final decision on these proposals before the latest date for a decision set out in the Final Modification Reports (“FMRs”) for each of the Losses Proposals (the “Decide-by Date”) (that date being 20 September 2007).

In December 2007 a judicial review was brought by four generators who challenged whether the Authority had any power to reach a decision on the Losses Proposals after the Decide-by Date had lapsed. The High Court found in favour of the claimants and issued an order on 2 July 2008 (the “Judgement”) which provided that the Authority has no power to approve a proposed modification to the BSC if the proposed Decide-by Date had passed.

The July Implications Letter highlighted some of the practical implications of the Judgement. For example, it noted that there may be constraints on the Authority’s ability to evaluate any concerns raised by stakeholders regarding its, or industry’s, assessment of proposals. It also noted that there are risks that the potentially considerable resources committed to considering a proposed modification, both by the Authority and by industry, would be wasted if it “timed-out”. Consumers could directly suffer if a proposed change to the BSC that was in the public interest was delayed because a particular modification proposal could not legally be implemented.

<sup>1</sup> <http://www.ofgem.gov.uk/Licensing/ElecCodes/BSC/BSC/Documents1/Losses%20open%20letter%20%20-%20final-%2017%20July.pdf>

<sup>2</sup> P198, P198 Alternative, P200, P200 Alternative, P203 and P204.

<sup>3</sup> [http://www.ofgem.gov.uk/Licensing/ElecCodes/BSC/BSC/Documents1/070914\\_Zonal\\_Losses\\_Delay\\_Decision\\_Letter.pdf](http://www.ofgem.gov.uk/Licensing/ElecCodes/BSC/BSC/Documents1/070914_Zonal_Losses_Delay_Decision_Letter.pdf)

## ***Purpose of consultation***

In this letter we consider the implications of the Judgement and consult with industry participants, and other affected stakeholders (such as consumer representatives), on proposals which are intended to prevent Authority decisions on code modifications being “timed out”.

Whilst the Judgement related to the BSC, the letter also considers the implications of the Judgement for the Connection and Use of System Code (the “CUSC”) and the Uniform Network Code (the “UNC”) and consults on proposals to address the potential “timing-out” risks under each of these codes.

## ***Timing out - the risks and costs***

It is important at the outset to note that Ofgem fully understands the need for efficient and timely decision making on modification proposals and that this directly impacts on industry certainty and stability as well as bringing benefits to consumers. In recognition of this need, since 2005-06 we have committed through our Corporate Plan and Strategy to reach a determination on at least 70% of modification proposals in 25 working days or less. We have outperformed this key performance indicator in every year that it has been in place. Our performance stands at 90% during the current reporting year<sup>4</sup>. In addition to our key performance indicators, we also have, as a public body, a requirement to act reasonably in everything we do, including in setting our timetables for decisions we make.

However, we consider that there will always be a possibility that the Authority may need additional time to evaluate concerns and issues raised by respondents in the course of assessing a modification proposal. Further, it is not always possible to predict in advance the nature or scope of issues that might arise in the course of considering a modification proposal. Indeed, our experience of the recent Losses Proposals is that important issues that require further consideration can be raised later in the Authority’s assessment process.

In view of this, and given the potential adverse consequences of Ofgem/the Authority not being able to make a decision within the set timetable (some of which are discussed further below), it is Ofgem’s view that time limits should not be placed on its decision making process in cases where the subject matter of a proposal is not fundamentally linked to a date related event.

The adverse consequences of “timing out” of Authority decisions on code modifications include:

- **Wasteful loss and duplication of resources.** The Judge noted in the Judgement that:

*‘if the Authority had no power to give itself additional time necessary to evaluate the Proposed Modification in the circumstances which have unforeseeably arisen, the whole exercise – including the work done by the Panel and the Authority – would be frustrated, with the probable attendant waste of time and resources [...]. I accept that the exercise could be re-run with a new timetable, but this would appear to be an inefficient and wasteful duplication of procedures without any countervailing benefits’.*

We agree with this conclusion. The risk of wastefulness is not restricted to transmission loss proposals and could apply to any circumstance where the Authority’s decision making is constrained by an “artificial” Decide-by Date. We do not consider this to be efficient, in the interests of industry or in the interests of consumers.

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<sup>4</sup> The percentage figure stated reflects position on 12 November 2008. The reporting year runs from 1 April to 31 March.

- **Losing or delaying consumer and industry benefits.** The Judgement also noted that timing out may result in *'the potential lost opportunity of securing a Modification that might well bring substantial benefits to licensed persons, and users and consumers of electricity'*. Even if a "timed-out" proposal that was otherwise capable of Authority approval were re-raised, and subsequently approved, its benefits may be reduced or removed by this delay.

*In the light of these concerns, we believe there are strong arguments to introduce measures that would ensure that Authority decisions are not unnecessarily "timed out" in the future.*

### ***Industry initiatives to address "timing out" risk***

We note that the BSC Panel recently consulted with BSC signatories on the structure and application of implementation dates put forward under that code, and whether an extended fall-back or open-ended implementation date should be submitted to the Authority for some proposals<sup>5</sup> (the "BSC Consultation"). Responses to that consultation indicated that there was opposition to such a move. Some industry participants suggested that it is right and proper that a proposed modification may potentially "time out". Four core arguments are cited in support of this view:

- That the Authority could avoid the risk of timing-out by forewarning the BSC Panel and modification groups that it will have difficulty meeting the decision-making timetable proposed, thereby allowing the BSC Panel to adjust its timetable to account for this;
- that the risk that a modification proposal may "time out" creates a necessary incentive on the Authority to make prompt decisions;
- that unconstrained Authority decision windows may create regulatory uncertainty, and that businesses need certainty on when decisions will be made; and
- that the analysis contained in industry's assessment of modification proposals may become out-dated and either inaccurate or misleading, if it forms the basis of a significantly delayed decision.

Whilst the BSC Panel is likely to give consideration to the specification of long-stop dates or open ended implementation dates in BSC FMRs, in view of the strength of responses received to the BSC Panel consultation, there remains a possibility that these mechanisms will not be used going forward. Even if long-stop dates were to be introduced in BSC FMRs, this would still create a deadline by which the Authority would be required to make a decision, and therefore, "timing out" risks will remain.

In addition, Ofgem does not accept all of the arguments that are cited above. For transparency and in order to inform this consultation, we provide our current views on these arguments in the appendix to this letter.

### ***Implications of the losses judgement for CUSC and UNC***

Whilst the Judgement was made in relation to a suite of competing proposals that sought to amend the BSC, there are obvious risks that its implications will not be viewed as limited to that code. For example, the relevant licence, and code provisions in relation to the CUSC are very similar to the BSC and we consider that there is a significant likelihood that the Judgement would be viewed by a Court as having similar implications for the CUSC. In terms of the UNC, the differences between the relevant licence and code provisions have led us to conclude that a Court is less likely to consider that the Judgement applies.

<sup>5</sup> [http://www.elexon.co.uk/consultations/closed/default.aspx?start\\_date=01/01/2008](http://www.elexon.co.uk/consultations/closed/default.aspx?start_date=01/01/2008)

However, we consider that there are residual “timing out” risks under the UNC for modifications that include specific implementation dates, which it is appropriate to address in this letter.

### ***Ofgem’s proposals***

We propose to modify the licence conditions which govern the BSC, CUSC and UNC to remove the potential that modification proposals relating to those codes may “time out” before the Authority can conduct, procure, or consider information that is necessary for it to make a decision; a position that we consider was probably intended (although clearly not achieved) by the existing licence drafting. In order to achieve this, we intend to propose modifications to the National Grid Electricity Transmission licence with respect to the BSC and CUSC processes. We also intend to propose modifications to National Grid’s gas transporter licences in respect of its National Transmission System and retained distribution network businesses, as well as to the gas transporter licences of the other gas distribution networks.

We have identified two potential approaches. These are described below and we would welcome stakeholder views on these options:

- **Option A:** under this option the Authority would be empowered to vary implementation timetables prior to reaching a decision on a proposal and following consultation.
- **Option B:** under this Option, the Authority would be empowered to request a revised implementation timetable, including a new “decide-by” date(s), for a modification proposal(s) currently with the Authority for decision. This request would be made to the relevant code Panel, who would be obliged to comply with the request. To avoid any risk that the Panel could simply replace one decide-by timetable that is not viable with another one that is also not viable, the request could include binding directions setting out a minimum length of time for which the new decide-by date(s) must be valid.

### ***Other codes***

We do not propose to take action in relation to any industry codes other than the BSC, CUSC and UNC at this stage because we consider that the implications of the Judgement for the other codes is less likely to adversely constrain the Authority’s decision-making on modification proposals. We would welcome views on whether the restriction of changes to these three codes is merited, or whether we should also seek to make changes in relation to other codes.

Set out in Appendix 1 are Ofgem’s initial views in relation to the arguments against introducing more flexibility through one of Option A or Option B. We consider that both options provide the flexibility to ensure that the Authority’s modification decisions are not timed out and therefore address the risks identified above, namely:

- The risk of inefficient wastage and duplication of resources; and
- the risk that the benefits to consumers and industry of a code modification will be lost or delayed.

We would welcome your views on the need for greater flexibility and the options described above for achieving that flexibility.

## Way forward

We welcome views on the issues raised in this letter. These submissions should be sent to [industrycodes@ofgem.gov.uk](mailto:industrycodes@ofgem.gov.uk) by Monday 12<sup>th</sup> January 2009.

We will consider the responses received in order to further develop our proposals on how the practical implications of the Judgement should be addressed. We will formally consult on these more detailed proposals early in 2008.

Yours sincerely



Mark Feather  
**Director, Industry Codes and Licensing**

## Appendix 1

### *The arguments against introducing more flexibility – Ofgem initial view*

As we have outlined in the main body of this letter, industry participants have already specified a number of risks and downsides associated with introducing open ended or long stop implementation dates under the BSC. It is possible that industry participants will argue that similar downsides and risks might arise under each of the options above.

In order to further inform this consultation, we have provided some of our initial views on the arguments raised through the BSC Consultation against the specification of more flexible dates. These are provided below.

- **Ofgem forewarns the Panel of risks.** As noted above, it has been suggested that Ofgem should forewarn the relevant Panel of risks to the decision making process so that these can be taken into account in setting the timetable. In practice, Ofgem frequently communicates with Panels regarding its likely decision-making timetables for modification proposals and highlights whether it expects to conduct a regulatory impact assessment or take other steps that will affect when a decision can be reached. However we do not believe that it is realistic to expect Ofgem to predict with perfect foresight every issue that may arise during its assessment of a modification proposal. It is always possible for new issues to arise and to require consultation during the course of assessing a proposal and these issues cannot always be predicted during the Panel assessment processes. Indeed, our experience with the Losses Proposals is that last minute issues can get raised which could not have been foreseen.

We have a finite resource pot with which to meet our statutory duties and responsibilities, and remain committed to reducing our costs<sup>6</sup>. Modifications are only one of many demands on these limited resources. These competing demands can affect the timetable for consideration of a modification proposal, where higher priorities exist elsewhere. Our ability to deliver on our commitments cost efficiently is not aided by the existence of artificial resource bottlenecks resulting from the risk of proposals "timing out".

- **An incentive for timely decisions.** As noted above, it has been suggested that Decide-by Dates create an incentive for the Authority to issue prompt decisions. We do not agree with this argument. Since 2005-06 we have been committed by our Corporate Plan and Strategy to reach a determination on at least 70% of modification proposals in 25 working days or less. We have consistently outperformed this target. We also consider that there are natural incentives on the Authority not to take excessive time in reaching decisions without good justification, and the Authority is required to act reasonably in everything it does. Where a proposal provides consumer benefits then unnecessarily deferring a decision upon it may remove, reduce or delay these benefits. The Authority, of course, has a statutory duty to protect the interests of consumers. We see no compelling reason to believe that removing the risk of "timing-out" will have any material effect, positive or negative, on the incentives for prompt regulatory decision making, particularly in light of this statutory duty.
- **Industry uncertainty.** As noted above, some industry participants have argued that indefinite delays in the Authority's decision making could result in regulatory uncertainty, and could have an adverse effect on industry's ability to plan for major investment decisions. However, we do not believe the argument that unconstrained decision timescales will result in tardy regulatory decision timescales to be borne out

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<sup>6</sup> Currently we operate under a five-year cost control regime that runs 2004-2009. It pegs our expenditure growth at 3 percentage points below the retail price index. This will reduce our costs by more than £5 million in real terms by 2010.

by existing practice. For example, the vast majority of FMRs already contain unconstrained Authority decision windows and, despite this, as indicated in the previous section of this letter, we continue to make the majority of decisions in 25 working days or less.

We do acknowledge that a minority of modification proposals do take longer to decide upon, and that these can include some (though not all) of the most contentious – and by implication, commercially significant – decisions. However, because of the significance of these decisions we consider that it is appropriate that the Authority can have full confidence that it has the information it needs to reach the correct decision. If this means that further analysis of a modification proposal is required after its FMR has reached us (and potentially after the Decide-by Date that was stipulated in that FMR), in order to address new concerns or gaps in the information provided to us, we think that it is appropriate that this should be possible.

Furthermore, we do not agree that the current code arrangements position, nor the existence of constrained decision timetables prevent regulatory uncertainty. In practice, were a modification timed out, an entirely new proposal with the same parameters can be raised with the procedure being re-started for effectively the same proposal (indeed, this is what happened with the transmission losses proposals). The potential for the same proposal to be raised repeatedly is not conducive to cost efficiency or regulatory certainty. It would be better to allow for the full consideration of the proposal at its first hearing.

- **The validity of the analysis.** We agree that there is a risk that the facts and analysis underlying an assessment will change over time. However, a consequence of the Judgement is that if information or analysis that is directly relevant to the Authority's decision cannot be gathered or corrected before the proposal is "timed out" then the only way that proposal could be considered by the Authority would be for an entirely new modification proposal to be raised.

We consider that, rather than starting again with a completely new modification it would be more appropriate to provide a means to correct or supplement the areas where analysis is missing or which require further consideration.

In June, we indicated in our decision on the scope of the Industry Codes Governance Review that we intend to bring forward and consult on proposals that would enable the Authority to "send back" modification assessments to the code Panels as part of the code governance review<sup>7</sup>. The Judgement also refers to the potential value of a power to remit matters back to Panels for re-consideration. It is possible that such a power would help to address concerns that analysis had become out of date and we intend to consult in November on proposals to introduce such a power.

In the light of the above discussion, we are currently unconvinced by the arguments cited by industry participants during the BSC Consultation against the introduction of more flexibility in the setting of implementation dates.

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<sup>7</sup> <http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/GovRevScope%20-%20MF%20Final%2030%20JUNE%2008.pdf>