Mark Feather

2nd March 2009

Director, Industry Codes and Licensing

Dear Mark

Code Governance Review: Major Policy Reviews and Self Governance and the Role of Code Administrators and Small Participant - Consumer Initiatives

Thank you for the opportunity to respond to the above consultation. As you are aware the Association of Electricity Producers represents generating companies in the UK with our membership comprising a wide range of technologies utilising fossil, nuclear and renewable sources of energy. Our members include some of the largest through to the smallest UK energy producers many of whom actively participate in the development of all industry codes. We provide regular updates through our association committees for those who are unable to participate directly. Our response has been developed following an Association member code review meeting prior to your 11th February 2009 Workshop.

If you have any enquiries regarding this response please feel free to contact Barbara Vest, Head of Electricity Trading on 07736 107 020

Yours sincerely

David Porter OBE
Chief Executive

(By email)

APPENDIX 1

Our members have discussed the proposals and have articulated the following response to the questions posed within the following consultation:

Major Policy Reviews and Self Governance

CHAPTER: Two
Question 1: *Do you agree with our assessment of the deficiencies of the codes governance arrangements and do you agree that there is a case for reform?*

Association members have raised concerns previously regarding the lack of an overall strategic industry development platform. The provisions within the electricity Pooling and Settlement Agreement, for example, in this respect were not carried forward within the new Balancing and Settlement Code (BSC). Issues Groups (BSC) and Workstreams within the Uniform Network Code (UNC) have attempted to address such concerns, be that to a much more limited extent. On this basis we support the objectives of the review and believe that well functioning governance is an important part of a stable regulatory framework that promotes confidence in the market. Conversely, inappropriate reform will present serious risks to future developments in the UK energy market.

The Major Policy Review (MPR) proposal for key strategic developments is a significant change from the current arrangements. In order for this process to be effective and efficiently implemented there needs to be far greater discussion and detail on the necessary controls, checks and balances.

Industry codes have been successful in delivering incremental change. Their ability to respond to strategic reform was recently tested during development of major transmission access review activity. Once DECC and Ofgem issued their Transmission Access Review (TAR) policy documentation, industry was able to assess and develop recommendations which are currently with Ofgem. As a result we believe that appropriate routes are already in existence which are fit for purpose without the need to extend Ofgem powers. We recognise there is always room for improvement.

Are the proposed reforms a proportionate response to the problems with the status quo that we have identified?

Association members do not believe a proportionate response is one which elevates the Authority beyond its current remit to one of judge and jury without substantial checks and balances. Indeed, in its most recent legal view (2008 hearing), the Competition Commission advised against any move towards such a regime. Such safeguards have not been articulated within this document.

Question 2: *Would the Major Policy Review process enable key strategic issues (e.g. electricity cash-out or transmission access reform) to be progressed more effectively and efficiently with consequent consumer benefits?*

No, not as currently proposed. Such an approach would delay reform in that any change would not be able to progress until Ofgem had concluded its findings. In addition, should the legally binding outcome be found to have misdirected the industry then this will lead the process into further disrepute. Our example here is based upon the initial response to the Transmission Access Review which led NGET to raise six CUSC amendments. All were based upon a zonal approach and all of which have been subsequently proven to be unworkable.

For cashout, incremental change was an appropriate industry response to deal with the associated issues as the methodology was widely believed by the industry not to be fundamentally broken, as was asserted by Ofgem.

There have also been examples of Ofgem-led reforms in the gas regime. In particular NTS exit reform, where Ofgem chaired working groups (ERAG and EOWG) and inserted licence conditions in NGG's licence to progress reform. These approaches did not work well and were successfully challenged via the Competition Commission route.

Furthermore it is not apparent that the MPR process as proposed would actually introduce the single holistic process that it aspires to do, since it may often be the case that the review leads to changes within several other documents and processes, not only the relevant code.

Finally, we do not believe that this would necessarily improve engagement by small participants and new entrants. If attendance within the current framework is proving difficult then there is no evidence that this would be any less onerous a route.

Question 3: *Would a Self Governance route be suitable for a significant proportion of modification proposals?*

Yes, but only if supported by an appropriate governance and appeals procedure and certainly not as part of a package. We do not believe that the appeals procedure should be any different for this route

Question 4: *If both the Major Policy Review and Self Governance routes were implemented, is there a case for retaining an Improved Status Quo path?*

Yes. Under the current proposal, the majority of change would go through this route. We believe the current process would benefit from improved Ofgem engagement.

Question 5: *If this package of reforms is implemented, should it apply to all codes? If not all, which? Should the introduction be phased?*

The reforms that are implemented should apply to all codes. Our comments above highlight our concerns and we would not support implementation of current proposals without the necessary checks and balances needed to prevent Ofgem becoming judge and jury for industry reform.

CHAPTER: Three
Question 1: *Once a modification has been raised, should the filtering decision be taken by Ofgem (with a panel recommendation) or by the relevant panel with an Ofgem veto?*

Noting our concerns previously highlighted in this response, we can see merit in the individual code panels being able to determine the treatment of each proposal, against a predetermined range of criteria which must include an assessment of time and industry cost benefits. Those raising modifications and amendments should be required to state their preference for either self governance or the status quo.

Question 2: *What criteria should be applied to assessing whether a modification falls into Path 1 or Path 2?*

This level of detail can only be ascertained once there is further clarity on the MPR process and the degree of checks and balances to prevent Ofgem becoming both judge and jury. We have concerns that the current definitions of Path 1 and Path 2 are rather broad yet only differ by the use of the term 'significant'. Definition of the term 'significant' is required.

Question 3: *How should we treat modifications that fall within the scope of an existing Major Policy Review?*

Until further detail on MPR's is available this cannot be assessed.

CHAPTER: Four
Question 1: *What process should be adopted for Major Policy Reviews?*

The existing arrangements within the gift of DECC, Ofgem and the industry have proven to be adequate, lawful and to date have been workable, effective and efficient. For example during development of the six transmission access review proposals the industry worked in parallel to develop both amendments and charging methodologies. The flexibility within the current framework allowed this and should be made to fit for future developments. This is not to say that ongoing improvements should not be sought.

Many of our members, both small and large, have generation projects that they wish to see progress as quickly and as efficiently as possible. A number of the delaying factors, such as planning consents, the current financial downturn and availability of skilled workforce are outwith the remit and influence of the industry codes.

Ofgem has previously experienced difficulties in looking to direct the electricity cashout review. Those difficulties were not resolved until industry progressed the debate using the existing industry framework.

Should Ofgem continue to seek reform we would need to ensure that:

- effective checks and balances were in place to prevent Ofgem from becoming judge and jury;
- both industry, through the code panels, and Ofgem, should be able to trigger a MPR;
- there is an appropriate appeals process whichever the route and
- MPR conclusions are recommendations and not legally binding as this would effectively remove all powers from industry panels and place too much emphasis on the views of one organisation.

Question 2: *What are your views on the Options for determining the outcome of a Major Policy Review?*

Association members do not believe that it within the remit of Ofgem to issue binding directions to any panel or licence holder in this respect.

Ofgem does not have the expertise within house to raise modification proposals and draft legal text - this resides within the industry. Therefore the costs associated with the procurement of external consultants to undertake the significant amount of work involved would result in a prohibitive and counter productive overhead borne by both industry and consumers. This is in addition to the costs of those consultants already retained for other ongoing tasks.

Question 3: *How ought the outcomes of a Major Policy Review to be implemented?*

The current process, i.e. leave it to the industry to respond, works well.

Question 4*: What safeguards and appeal mechanisms should be in place?*

The current appeals mechanisms work well, although it is perhaps apparent that the original aim that any appeal to the Competition Commission should be easy and affordable has fallen well short of expectations

Question 5*: Should there be a moratorium on subsequent code modifications following the completion of a Major Policy Review?*

No. Should the outcome be legally binding and wrong then industry and consumers would face the burden of unnecessary additional expense

CHAPTER: Five

Question 1: *If current Panel voting arrangements for any code are to be changed, which model is optimal (Independent Panel, Representative Panel, signatory voting)?*

The current Panel voting arrangements are fit for purpose.

Question 2: *Should it be mandatory for panels to have a consumer and a small market participant representative?*

Panel consumer representatives have played an important role to date. Providing an option to participate may be appropriate for codes currently silent on the issue. With regard to the current Panels should small market participants wish to participate and have the necessary expertise then the option to volunteer as a member is always available at election time. Most panels already comprise elected members who actively seek a wide range of industry views and have attracted the support of smaller participants in the past. Many current panel members actively seek smaller participant views as do code administrators.

Question 3: *What voting procedures should apply governing code decisions?*

Members support the simple majority route

Question 4: *What appeal mechanisms should be in place? Should defined appeal arrangements be set out or should Ofgem have discretion over whether or not to hear an appeal?*

Ofgem should always hear an appeal, therefore this option must be available for any modification or amendment raised and should be reinstated within the proposed framework for Option 3.

Question 5: *Should a consumer and small participant representative have an automatic right of appeal?*

Equal treatment should be afforded to all code signatories, therefore small participants have as much right as others to raise an appeal.

CHAPTER: Six

Question 1: *Do you agree with our assessment of the package of reforms against the Review Objectives?*

Association members do not believe that the current proposals offer a proportionate response to the current issues. Reforms that elevate the Authority beyond its current remit to the role of judge and jury require appropriate checks and balances in place. Such safeguards have not been adequately addressed in this consultation.

The success of any self governance route will be judged on the volume of modification proposals directed through it. Without further information regarding the filtering process assessment of this option is limited.

Question 2: *Do you agree with our quantitative assessment of the potential cost savings of reform?*

We offer no view at this stage as there is too little information to aid a robust assessment. It is not self evident that the estimated cost savings will be achieved without the risk of stifling debate and limiting the options for reform. The potential costs arising from unintended consequences also need to be considered.

Question 3: *Do you agree with our assessments of the potential impact of reform on consumers, competition and sustainable development?*

The consultation includes the following incorrect and misleading statement '*It is important to note that many of the smaller participants who struggle to engage in existing codes processes, due to their complexity and resource intensive and piecemeal nature, are smaller generators, often from the renewable sector (including distributed generation). This has been particularly the case with the Transmission Access Review process where smaller generators have found it difficult to engage in the code modification and policy development process'.* This is in fact the worst possible example that should be used as it is a matter of public record that all three of the Working Groups established to take forward development of the six transmission access amendments were well attended by smaller participants or their representatives. It is difficult to understand what additional actions could have been taken during Ofgem imposed tight development timetable. Both Ofgem and NGET now need to follow this up with some wider explanatory workshops to encourage debate and understanding of the potential business impacts of the six proposals, particularly ahead of publication of the Ofgem Regulatory Impact Assessment. This would be beneficial for all industry participants.

Additionally it should be noted that the industry responded positively, across codes and quickly to the Ofgem 'guidance' document dealing with carbon assessment. An over prescriptive regime would stifle such an innovative and constructive approach.

Question 4: *Do you agree with our assessment of the potential unintended risks and consequences?*

Ofgem states that '*Under Options 1 and 2 (for the Major Policy Review process, as set out in Chapter 4) industry participants use the modification process to undermine the outcomes of the Major Policy Review. This risk would be mitigated if Ofgem had backstop powers to raise its own modification(s) if those put forward are unsatisfactory'.* The major risk to this whole process is not that the industry may undermine the process but that Ofgem is actually seeking to use this review as a means to extend its current

remit way beyond what is reasonable for an industry regulator. Members do not support an extension of regulatory powers to this extent.

APPENDIX 2

Role of Code Administrators and Small Participant - Consumer Initiatives

Association members agree with Ofgem that the elements of the code arrangements within their gift to govern have worked well to deliver reform and change. The governance regime is inclusive and equal, well documented within the relevant codes and efficiently administered. We accept that there are always process improvements to be made, however, our members believe that this should be within the gift of the panels and code administrators to deliberate and take forward, rather than require a specific initiative by Ofgem. The industry bears the cost incurred in support of the processes, albeit some of those costs are better understood than others. Therefore, now that this debate has started we would propose that the industry and code administrators, with the support of Ofgem, take forward this initiative to deliver some quick wins rather than waiting for sometime in 2010 when Ofgem delivers its final report.

Our members have discussed the proposals and have articulated the following response to the questions posed within the following consultation:

CHAPTER: Two
Question 1: Are the Authority's concerns regarding the quality of analysis undertaken through the code modification processes justified?

It is disappointing that after many years of operation under the various codes, Ofgem is now raising concerns regarding the quality of analysis via such a review, rather than directly with the code administrators and industry. Ofgem attends working groups, modification groups and panels and as such contributes to and reviews the output from all meetings. Engagement by Ofgem is paramount; indeed this surely must form part of the ongoing role of the industry regulator. To do so now, via this route, is rather late in the process and inappropriate. The time and place to do so is during the ongoing development process, with the support of the relevant code administrator.

Question 2: Are some code administrators more accountable than others?

Yes, but that is due to requirements within the specific codes. The case for change must be proven to deliver proportionate cost benefits, with solutions sought through the best practice route, rather than imposed via code modifications which can prove limiting and inflexible.

Question 3: We consider that code complexity is a problem, particularly for small participants, new entrants and consumer representatives. Do you agree? How can the complexity be reduced?

The governance regime is inclusive and equal, well documented within the relevant codes and efficiently administered. We must take into account that the industry codes form only a small part of the overall complexity any participant has to understand to operate within this industry - for example, company law, health and safety, through to project management, planning laws and basic finance.

Most code administrators, trade associations and industry participants offer guidance to aid understanding of key issues. However a number of members have referred to the fact that Ofgas used to provide a brief overview of change proposals which may impact consumers. This point was raised at your 11th February 2009 workshop. We assume that an internal briefing note is already produced on a monthly basis to inform Authority members of industry initiatives, therefore widening publication to industry participants should not create significant additional work or cost. Publication on the Ofgem website would be helpful, together with the Authority meeting timetable (including future topics for debate), meeting agenda and minutes. The Terms of Reference for the Demand Side Working Group and Consumer First project for example could also be extended to include quarterly updates of industry code developments for members who may find this of benefit.

Question 4: *Do small participants, new entrants and consumer representatives find it difficult to engage with the code modification process?*

Association members are fully briefed regarding industry code developments and are encouraged to seek assistance as and when required. It is also the case that most industry meetings are open to anyone who wishes to attend and participate in the debate. We recognise for those members who cannot attend that we, as their trade association, do so and provide relevant and timely feedback.

We recognise that there are other groups which have included smaller participants and consumer representatives, specifically recognising value in their input and rewarding this via an attendance fee. One such example is that of the Energy Network Strategy Group and its sub committee the Distribution Working Group (stood down in September 2008) which have been seen to be a useful vehicle for engagement in the past. Ofgem should assess whether there is value in reinstating the Distribution Working Group to ensure the opportunity for continued engagement from the distributed generation community.

CHAPTER: Three
Question 1: *Do you agree that the quality of analysis in code modification reports could be improved? Should the role of the code administrator be changed to help enhance the quality of code modification reports?*

We would be concerned if code administrators strayed beyond their current remit however it should fall upon the Chair of all working group and modification groups, members and panels to ensure that the Terms of Reference have been fulfilled, including the complete analysis of the proposal in question

Question 2: *Which of the options for changing the role of the code administrator in the modification process (critical friend or active secretariat) is most appropriate? Should different options be chosen for different codes?*

Their current role is adequate, however, in some cases, it could be better explained and/or advertised

Question 3: *Should the roles of the administrators of the BSC, UNC, CUSC, Grid Code, SPAA and MRA in respect of central systems management be harmonised i.e. should all code administrators either be made responsible for the related systems or should this responsibility be removed from them all?*

The way the code administration roles have developed is appropriate given the history behind individual codes.

CHAPTER: Four
Question 1: *Should code administrators be independent of network owners? If so, is it sufficient to have management unbundling or should the code administrator be an independent company?*

The way the code administration roles have developed is appropriate given the history behind individual codes.

Question 2: *Should all the major commercial codes have the same corporate governance structures? What is the most appropriate governance structure?*

The way the code administration roles have developed is appropriate given the history behind individual codes.

Question 3: *Are code administrators and the management teams for CUSC, UNC and BSC sufficiently accountable in terms of their costs and performance? Do they have clearly defined objectives and measurable performance targets?*

The BSC model includes significant industry development in the annual budget and business planning process. Improvements regarding cost and transparency would be welcome within the other codes however it may not be necessary to go to the extreme of the BSC approach.

Question 4: *Code administrators are currently funded by cost pass through, service contracts or price controls. Which of these funding arrangements is the most transparent and accountable?*

The price control route is the least transparent.

Question 5*: Is there an argument for considering the service contract approach to funding for more codes if a degree of self governance for a code is introduced?*

Does this have to be linked to self governance?

Question 6*: Should the funding of the code administrators for the CUSC and UNC be removed from the relevant network owner price controls?*

This may not be necessary if transparency around the process could be improved.

CHAPTER: Five

Question 1: *Should Ofgem have powers to "call in" and "send back" modification proposals? What are your views on the "call in" and "send back" options?*

The consultation states that it could *"call in" modifications when Ofgem considers that the progress of a modification is too slow or inadequate (or deficient) analysis is being undertaken; and "send back" modifications sent to Ofgem for decision when the analysis undertaken is deficient.* Ofgem would be admitting that it had failed in the whole procedure if exercising such powers. There is already provision within the current process for development and assessment of code modifications when Ofgem has the ability to engage in assuring all views have been satisfactorily aired. If Ofgem believes that call in and send back features are attractive and that the ability to do so is within their remit '*without fettering their discretion*' then why is it not doing so now?

Question 2: *Should all code Panels have to publish the reasoning behind their recommendations?*

Yes, with reference to the applicable code objectives against the current baseline.

Question 3: *Should code administrators be able to raise modifications themselves? If so, should there be limits on what modifications they can raise or should they have to gain the consent of the code Panel to the raising of the modification?*

The BSC currently provides for the Panel to raise modifications under certain circumstances. This ability should suffice; in that to raise wider ranging proposals would make provision of an independent code administration service possible due to the potential conflict of self interest such a move would raise

The current rules provide for Gas transporters to be made responsible for the development of the rules, systems and processes which relate to their individual gas networks through their licences. In such cases they also acquire a right to vote in support of their own proposals. Members believe that this right should not apply as this provides for influence above and beyond that of the other code signatories .i.e. this is no longer a level playing field approach

Question 4: Would it be useful to develop a code of practice applying to all code administrators? Should it be voluntary or binding?

The current tripartite code administrators' meetings should provide sufficient scope to share, and act upon, best practice. Currently code administrators meet and discuss developments within their areas of expertise. We believe the meetings would benefit from greater transparency and industry input, especially around the production of panel documentation including, for the Connection and Use of System Code (CUSC) and Uniform Network Code (UNC), enhancement to the content with regard to the reporting of the full cost and benefit of particular modifications and code amendments. Another initiative our members support would be to look at the potential to adopt the gas approach towards modification ownership, variation and withdrawal. Early improvement within the Balancing and Settlement Code (BSC) in this area would be appreciated.

We believe the code administrators, aided by industry input, should lead this work and report to the individual panels where it is suggested that improvements can be made, preferably looking at improvements on how to interpret the code rather than create a whole range of new code modifications. This item should be included on each meeting agenda alongside the debate of minutes and actions. Ofgem should participate in this development in order to ensure that, where improvements to working practice can only be achieved by raising code modifications, these can be dealt with by Ofgem expediently. Improvements should quickly be realised if we ensure a 'let's do it' attitude rather than seek out legal impediments to stifle innovation.

An attempt should be made to coordinate meeting timetables across the codes and experience of the latest technological innovation should also be shared, in order to ensure the opportunity of maximum input from all who wish to participate.

Question 5: What are the most appropriate mechanisms to evaluate the performance of code administrators? Is a scorecard approach appropriate?

This issue should be debated at the next tripartite code administrators' meeting in order to formulate further ideas for consideration by the relevant panels.

CHAPTER: Six
Question 1: Do small participants, new entrants and consumer representatives face significant hurdles in engaging with the code governance processes?

As previously stated Association members believe the governance regime is inclusive and equal, well documented within the relevant codes and efficiently administered. Elexon has recently been through an extensive program to simplify market entry processes. If there are relevant lessons to be learnt then these should be shared

Question 2: *What are the key issues that need to be addressed in order for small participants and others to better engage with the code governance processes?*

Association members believe that the governance regime is inclusive and equal, well documented within the relevant codes and efficiently administered. Code administrators are one additional, helpful and knowledgeable resource available to new entrants. Sufficient information should be available on their website to ensure that this aspect of their role is publicised

Question 3: *Do you have any views on the options highlighted in this chapter? Do you have any views on the advantages and disadvantages discussed under each option?*

There are many routes available to what Ofgem term as 'smaller' players. As a trade association we ensure that all our members are catered for depending on their needs, that their views are sought and given equal status alongside their fellow members. We believe code administrators strive to achieve this goal. Through appropriate chairmanship of working groups and modification groups all views are treated as equal and reflected within final modification reports. If at any time Ofgem feels that this has not been the case, then there are many opportunities throughout the development cycle to raise concerns and ensure they are acted upon.

Currently the BSC, UNC and CUSC panels include representatives from consumerwatch.

Question 4: *Which options, if any, do you consider will allow small participants and others to engage better with the code governance processes?*

Improved Ofgem and code administrator communication and openness should improve the experience of all parties. Advocacy by code administrators would affect their ability to behave in an independent manner and raise unacceptable conflict of interest issues

Question 5: *Are there other options which we have not yet considered which may assist small participants and others to play a fuller part in the codes governance processes?*

De-scoping this review and encouraging improved dialogue between code administrators and the industry code signatories, who ultimately pay for their services, should ensure the delivery of improvements. In so doing, this also gives Ofgem the opportunity to seek to deliver operational improvements which, in parallel, will save the industry, code administrators and Ofgem time and so deliver benefits to consumers and industry alike without unnecessary delay. Improvements could take the form of increased interaction within the code change process e.g. providing constructive feedback during the modification development and assessment phase as to whether

sufficient analytical evidence has been sought, or whether a report is sufficiently clear in its content and conclusions prior to finalisation.