



Mark Feather
Director, Industry Codes and Licensing
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

27th February 2009

Dear Mark,

Code Governance Review: Major Policy Reviews and Self Governance

Drax Power Limited ("Drax") is the operating subsidiary of Drax Group plc and the owner and operator of Drax Power Station in North Yorkshire. We are pleased to have the opportunity to respond to Ofgem's consultation on Major Policy Reviews and Self Governance.

Drax welcomes the review into code governance and believes it is good practice for Ofgem to periodically review the governance process. A full response to the questions raised by the consultation document can be found in Appendix 1; however, Drax would like to put forward the following high-level views:

- Ofgem currently raise Major Policy Reviews under the current regime and, therefore, should be able to continue to raise Major Policy Reviews in the future, provided that there is an appropriate and quantifiable justification for doing so;
- The addition of a Self Governance path may have merit for those issues that do not have a material impact on competition or consumers, although the path could be implemented separately to the other measures that have been 'packaged' as part of the proposals in the consultation document;
- There should be the ability for both Ofgem and the code panels to escalate modifications on a Self Governance path to the status quo path;
- Should a Major Policy Review path be implemented, both Ofgem and the relevant code panel should be able to escalate a modification to the Major Policy Review path, provided there is an appropriate and quantifiable justification for doing so;
- If Ofgem were to be the sole party to determine which path a new modification should take, this process should be open to consultation; however, Drax believes that there may be merit in considering whether route determination should be made by an industry "Filtering Panel" (with Ofgem, industry and code administrator representation);
- The conclusions of a Major Policy Review should *not* be legally binding, but *should* be used as guidance when parties raise related modifications;
- Code signatories should be able to raise a modification at any time, even when there is a related Major Policy Review in progress, although assessment of the modification could be postponed until after the conclusions of the Major Policy Review are known;
- Ofgem should not be able to raise modifications, although code panels and code administrators could be allowed to raise modifications when the conclusions of a related Major Policy Review are known (again, provided there is an appropriate and quantifiable justification for doing so);

- Every path should have a Competition Commission appeal process available that *any* signatory can initiate;
- If the conclusions of the Major Policy Review were to be legally binding, there should be a Competition Commission (merit based) appeal process available upon release of the conclusions;
- Drax sees merit in code panels using the Independent Panel approach, in a similar way to the current BSC arrangements; however, each industry code should be reviewed on an individual basis and should have a governance structure that is appropriate for the purpose of the code;
- Drax believes that the structure of industry code governance should allow the regulator to maintain its independence, so that it is able to operate on an impartial basis.

If you would like to discuss the views expressed in this document, please feel free to contact me.

Yours sincerely,

Stuart Cotten

Regulation
Drax Power Limited

Appendix 1

Code Governance Review: Major Policy Reviews and Self Governance Questions

Chapter 2: Key issues and Objectives

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

It appears reasonable to say that there are inefficiencies in the process: multiple proposals for the same defect could be raised, multiple sets of analysis may be required by the working group and the regulator, the process may appear piecemeal in terms of similar proposals being suggested at different points in time, etc. However, the industry codes are structured in a way that allows *any* signatory to raise a modification regarding *any* identified defect.

Whilst the regulator, code panels and industry participants may be able to identify “major policy” work-streams upon receiving a modification request, it is fair to say that there are occasions when the solution with the most efficient outcome may only be identified after the original modification has undergone substantial development, analysis and testing (i.e. an outcome of an evolutionary process). The ability for parties to identify alternative solutions and raise new modifications at *any* time enables the most efficient solution to prevail, even if it was not identified until later in the process.

The consultation document states that *“it should not be a pre-requisite of reforms that all parties agree by consensus on the need for reform or the nature of the reforms that should be progressed.”* This is very true, although it should not be used as an excuse to ignore the opinions of those stakeholders affected by, and potentially opposing, such reform. The current process does not require consensus in order to progress reform; however, if such reform is opposed by a significant proportion of the industry, such opposition should be noted.

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?

It could be argued that the Transmission Access Review took this route, and that the regulator has the ability to conduct such reviews, under the current arrangements (except there are no legally binding conclusions from the initial review). However, with the cash-out proposals, P217 was tabled as a consequence of the P211 and P212 modification process. It is difficult to deduce whether P217 would have been tabled earlier without the outcome of the P211 and P212 development, analysis and testing occurring first.

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

There is certainly scope for an element of Self Governance, although there must be careful consideration regarding the checks and balances that would be required to ensure such a process is equitable for all participants. A modification that follows a Self Governance path may evolve into a proposal that causes a material effect on competition or consumers as the proposal is further developed; it is crucial that process exists to escalate a modification from a Self Governance path to a path that will involve independent determination. There must also be the addition of a Competition Commission appeal process as part of a Self Governance path.

What is considered to be a minor change for one company may be a material change for another; the process must be well defined and involve the views of the regulator, code administrators and industry parties.

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?

There is most definitely a case for maintaining a “status quo” path. Placing every modification that has a material effect on a number of parties through a Major Policy Review path would potentially lengthen the process, rather than make the modification process more efficient.

The status quo path, such as the process that the BSC currently uses, provides a half-way house for modifications that have the potential to cause a material impact on the industry, but do not require a full Major Policy Review.

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

Drax only currently engages (in any extensive way) with the BSC and CUSC processes; therefore, we may not be best placed to comment on the other industry codes. However, we appreciate that each of the codes covers a very different area of the industry, for example: network connections, trading, metering systems, settlement systems, etc. Therefore, one size may not fit all.

If such reforms were to be implemented across a number of codes, it may be prudent for the arrangements to be tested on a single code first, rather than implementing changes across all codes simultaneously.

Chapter 3: Filtering criteria

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?

If Ofgem were to be the sole party to determine which path a new modification should take, Drax believes that the process should be open to industry consultation. There could also be a formal appeals procedure in order to encourage good governance.

However, we believe there may be merit in creating a “Filtering Panel” with Ofgem, industry and code administrator representation. If there were a Major Policy Review route, and the Filtering Panel were to believe that a modification is (a) material to industry parties, and (b) there is a potential for multiple alternative methodologies, the panel could consult with the industry prior to allocating the modification to the Major Policy Review route.

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

The general criteria for classifying modification proposals appear reasonable. Once classified, there must be a process for escalating a modification proposal to a higher path. There must also be the potential for a Competition Commission appeal process as a part of each path.

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

Drax does not view a moratorium on new proposals that fall within an existing Major Policy Review to be acceptable. There may be instances where parties that do not have the resources to become involved in a Major Policy Review process believe that they have a solution to a Major Policy Review issue, but the party is not / has not been involved in the relevant work-stream or has become involved too late to influence the current debate.

The inability to raise a new modification that addresses an issue covered by a Major Policy Review would destroy one of the main benefits of the current code modification processes; the ability to propose a

solution to a defect at any time regardless of the size or resources of a given party. The moratorium may work to the advantage of those industry participants that have significant regulatory resources, as these parties are likely to be heavily involved in any review process from the beginning. However, it is conceivable that it may be appropriate to delay the assessment of a new modification that is raised during a Major Policy Review until the conclusions of the review are known.

Chapter 4: Proposed “Major Policy Review” process

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

Drax initially believes that Ofgem should have the ability to raise a Major Policy Review, should (a) a major deficiency within an industry code be identified, or (b) a modification be raised by an industry participant that is seen as having a potential to cause a material impact that requires further industry review. However, we also believe that the option to drop the original modification should lie with the modification proposer and not Ofgem. It would also seem more appropriate to make the decision to drop a proposal at the end of the review period, rather than at the start, in order to ensure that the Major Policy Review has addressed the originally identified defect.

Drax is unsettled by Ofgem’s comments regarding there being no need for a “one size fits all” process on Major Policy Reviews. Whilst we agree that the course of the process should reflect the nature of the modification / perceived defect in question, it is surely conducive to better regulatory practice that a defined, yet flexible, process is developed prior to the introduction of a Major Policy Review path. This should be developed in conjunction with relevant industry stakeholders.

Drax believes that an alternative to the outcome of a Major Policy Review could be that both the relevant code panel and the relevant code administrator each have the ability to raise a new modification (where there is an appropriate, quantifiable justification) on behalf of the industry, with the outcome of the Major Policy Review being used as guidance when developing the modification. However, we do not support the suggestion that the final documentation should be legally binding, nor do we support the option for Ofgem to raise a modification.

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

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

Drax does not believe that any of the options described by the consultation document are suitable. The outcome of a Major Policy Review should be a document that contains clear industry guidance on the “desired elements” of a modification (with justification) that would be required in order to rectify the perceived defect(s) that initiated the process. The outcome should not dictate to the industry how a particular problem should be solved, nor should the industry be forcibly obstructed from raising new modifications that may solve the perceived defect in a more efficient manner.

Whilst we believe the regulator should be able to identify perceived defects and raise a Major Policy Review (where there is an appropriate, quantifiable justification), it should only be signatories to the industry codes that raise modifications to the rules and procedures that govern their connections, trading, metering systems and settlement systems. The current code structure works in a way that aims to find the most efficient outcome for the industry as a whole, with the appropriate checks and balances to ensure no single user is discriminated against and that the end consumer is protected.

As previously mentioned, an alternative to the outcome of a Major Policy Review could be that both the relevant code administrator and the relevant code panel each has the ability to raise a new modification (where there is an appropriate, quantifiable justification) on behalf of the industry, with the outcome of the Major Policy Review being used as guidance when developing the modification.

Drax believes that the structure of industry code governance should allow the regulator to maintain its independence, so that it is able to operate on an impartial basis; the methodology and powers suggested in the consultation document may remove such impartiality. Whilst the document suggests that the Authority’s decisions would be open to appeal (which would ensure impartiality), it is conceivable that the

issues surrounding independence in decision making could lead to an increase in legal challenges. This would *not* be conducive to an efficient modification system and better regulation, nor would it be good value for consumers.

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

It is of utmost importance that any modification and, if implemented, Major Policy Review process has the correct checks and balances in place. As details above, Drax believes that all routes should have a Competition Commission appeal option at the end of the process.

Any Major Policy Review process that delivers legally binding conclusions as an outcome must be open to appeal via the Competition Commission at the time that the conclusions are communicated. It is an appeal process based upon the *merits of the case* that is required.

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

Absolutely not; the ability for any party to identify a potential alternative solution to an issue, regardless of what stage the process has reached, is a credit to the current system. Further to this, the proposed ability of Ofgem to veto new modifications after a Major Policy Review is completed (or, in fact, at any time) is most unwelcome. However, it is conceivable that it may be appropriate to delay the assessment of a modification that is raised during a Major Policy Review until the conclusions of the review are known.

Chapter 5: Proposed "Self Governance" process

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

Drax believes that the Independent Panel approach would be most optimal in most circumstances, i.e. similar to that of the current BSC arrangements; this approach appears to work well. We also believe that the same panel should be used for Path 2 and Path 3. However, as previously mentioned, each code should be considered individually, based upon the nature of the system(s) that the code governs.

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

This appears reasonable, provided that all representatives are independent, i.e. obliged to reflect a personal view when voting, rather than the view of their employer or sector of the industry.

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

It would seem most appropriate to have a simple majority vote with an Independent Panel approach. However, as previously mentioned, each code should be considered individually, based upon the nature of the system(s) that the code governs.

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?

Firstly, there should be a mechanism to escalate a modification from Path 3 into Path 2. Given the filtering process that would take place when a modification is raised, and the type of modification that is expected to be allocated to Path 3, both the Independent Panel and Ofgem should have the ability to instruct a change of path. Drax believes that Ofgem should not have a veto over the decision of the panel to change the path, nor should only particular members of a panel have the right to change the path. Any

party should have the right to put their concerns to the panel or to Ofgem with regards to a potential change of path.

Secondly, there should most definitely be an appeals mechanism for every route. All participants should have the right to appeal, not just specific groups or particular panel members. Further to this, Ofgem should not have discretion over whether to hear an appeal; it should be a signatory's right to have their views heard.

Ultimately, every route should have the ability for a party to take the decision to the Competition Commission for an appeal based upon the merits of the case.

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

As mentioned above, we believe that all signatories to a particular code should have the right to appeal; therefore, if a small party wishes to appeal, it can do so. Further to this, a small participant could ask the code panel, or Ofgem, to consider escalating the modification from Path 3 to Path 2.

Modifications following the Path 3 route should have met set criteria, i.e. they should not have a material impact on consumers or competition. If the consumer representative later identifies a potential material impact on consumers, they should be able to ask both (a) the panel, and / or (b) Ofgem, to elevate the modification from Path 3 to Path 2.

Chapter 6: Impact assessment

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

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

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

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

At this stage, it is too early to assess the reforms against the original Code Governance Review objectives or to agree on the potential for cost savings as a result of implementing reforms. There are currently too many variables to consider; only when the responses of market participants have been received and taken into account by Ofgem, and a final proposal is put forward by Ofgem, will we be able to consider a more accurate picture of potential cost savings as a result of code governance reforms.

We look forward to viewing the responses from other market participants, along with Ofgem's opinion and proposed way forward after considering industry comments.