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Dear Mark

Code Governance Review: Major Policy Reviews and Self Governance

EDF Energy welcomes many of the strategic options set out within this consultation paper and the open approach Ofgem has taken to reviewing the Industry Code arrangements. Given the current political climate and environmental pressures it is understandable that Ofgem wishes to take a more proactive role in the delivery of key strategic initiatives. The co-ordinated and targeted deployment of regulatory reform could help ensure that any necessary changes to industry arrangements are delivered in an efficient and effective manner, thus ensuring that benefits to consumers are derived in a more timely manner.

Major Policy Reviews

We support Ofgem's view that a more coordinated approach to the delivery of strategic change would be beneficial to market participants and to consumers. Experience over recent years has demonstrated in some cases the difficulties that can potentially result from a piecemeal approach to strategic reform. However, we have serious concerns as to how Major Policy Reviews (MPRs) will be conducted and the potential increase in powers Ofgem is seeking to achieve. The consultation document does not include the requisite level of detail for market participants to fully test the likely implications of any option for MPR's. Ofgem should be seeking to receive a "mandate for change" from market participants. This mandate cannot be provided without considered assessment of the available options for MPRs.

The regulatory risk market participants may be subject to as a result of an MPR being inappropriately delivered are significant and could result in unacceptable investment risks. There could also be a risk of regulatory interference in established property rights, which would again undermine our confidence in the existing arrangements. Ofgem needs to demonstrate its commitment to enhancing market arrangements to benefit competition/consumers, without imposing unnecessary risk on market participants.

We believe there are potential pitfalls with all three options for MPRs, and so we cannot support any of the options as currently presented. Briefly these comprise:

- risks of the MPR process being abused to achieve short term political / regulatory gains rather than the long term strategic reform for which it is intended;

- potential undermining of the existing appeals mechanism;
- Panels and working groups expending considerable effort and resource developing solutions based on principles which Ofgem vary/amend at will;
- modification proposals and legal text produced by non code parties which may lead to inaccurate/incomplete modifications being progressed to implementation; and
- Ofgem playing the role of “judge and jury”.

Another concern EDF Energy has with regard to the MPR process is the ability of Code Parties themselves to raise collective issues to Ofgem for consideration and progression via this MPR process. There needs to be a mechanism for industry participants to raise significant cross-Code issues which they believe meet the MPR criteria for progression under that process. Without the ability to access this route, market participants will be unable to progress issues of significant consumer interest. For example, shippers and suppliers have for a number of years attempted to progress standardisation of service across Independent Gas Transportation Networks to reduce the problems of interoperability which have significantly negative consequences for consumers. A properly developed MPR process would provide the vehicle for effecting this change.

We recognise that there needs to be a mechanism by which major strategic policy issues can be progressed via an appropriately developed Major Policy Review (MPR) process, as this could deliver real benefits. However, any increase in regulatory control over the code modification process as part of this requires appropriate checks and balances to be built into the governance process, in order to protect market confidence and reduce the potential adverse impact on market/regulatory risk. We agree that licence amendments may also be required for any particular MPR, to ensure that the outcomes of the review can be properly implemented.

Self Governance

We welcome the move to embed enhanced self governance processes within the industry Codes. This has proved to be extremely effective under the auspices of the Master Registration Agreement and the Supply Point Administration Agreement. Code Parties should be making the decisions on the majority of technical, non-strategic modification proposals raised. We agree that enhanced self governance processes should be applied across all Codes, as the efficiencies derived will deliver benefits to all Code parties and hence to customers.

Structural Reform of Codes

In order to achieve these benefits, there will need to be structural reform of the Codes to reflect the principles of self governance.

- Code Panellists should not be “independent industry experts” – they should be parties to the Codes.
- Code Panels should take more of a strategic role in relation to the administration of the Codes rather than focusing on decision making activities on Modifications. This strategic role will also facilitate active engagement with Ofgem in relation to MPR’s.
- Consumer Representatives should have seats on Code Panels
- Decision making on modification proposals should be by super majority of representative constituencies. Each Code should design the voting process for

modifications on common principles, but there will need to be flexibility to take into account the differing market participants involved in each Code.

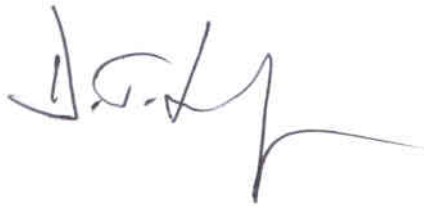
- Where modifications are being managed under the Improved Status Quo route, Code Parties should submit formal votes to the Code Administrator, which should then be passed to the Authority for decision.

There are a number of proposed reforms that we do not support, in particular, the automatic appeal rights for consumer representatives and small participants and the ability of Ofgem to have discretionary powers over whether or not to hear appeals. The rationale for our views on these topics is set out in the attachment to this response.

In summary, we welcome the strategic approach Ofgem is taking with regard to reforming the industry Code arrangements and generally support some of the reforms set out within this consultation.

If you require any further information or would like to meet with us in person to discuss our response, please contact Rosie McGlynn on 07875 111 488 or myself.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D. Linford', written over a light blue dotted background.

Denis Linford
Director of Regulation

Attachment

Code Governance Review: Major Policy Reviews and Self Governance

EDF Energy's responses to specific questions

Chapter 2

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?

We agree that there is a requirement for improvements to take place across all Codes to improve how Modifications are managed. The Codes have all evolved at different rates and to differing levels of complexity in relation to their administration. We agree that some of the proposed reforms are a proportionate response to the problems with the status quo described in the consultation. A large volume of Modification Proposals currently issued to the Authority for decision are technical and non-strategic in nature and have no direct impact on consumers. It therefore makes sense for Code Parties to make the implementation decisions.

However, we do not support automatic appeal rights for small participants and consumer representatives, as this is not a proportionate approach to take. Appeal rights should be common to Code Parties and should not be applied in an asymmetric manner.

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?

An appropriate Major Policy Review process would enable key strategic issues to be progressed more effectively. However, the existing deficiencies in the code governance process do not justify the potentially significant increase in powers that will be provided to Ofgem through the proposals as drafted. The possibility of Ofgem becoming the instigator, developer, draftsman and ultimate decision maker on code modifications does not meet best regulatory practice and introduces significant additional regulatory risk to market participants. Furthermore, as drafted there are insufficient appropriate checks and balances built into the process in order to reduce this regulatory risk. The ability of a party to challenge a decision on a code modification proposal that is simply complying with earlier legally binding review conclusions via the existing appeals mechanism is uncertain. Comparison has been made by Ofgem with the licence modification process whereby Ofgem undertakes a similar instigator through to decision maker role. However, we consider that the collective licence modification process with blocking thresholds is a much more effective, timely and less costly route to challenge regulatory decisions than the Competition Commission appeals route.

Whether the consequent cost savings and consumer benefits are as marked as described in the consultation is up for debate. The level of cost savings cannot be properly assessed until an MPR has been progressed through its anticipated life cycle. EDF Energy supports the intention to carry out a Post Implementation Review.

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

Yes, for certain industry codes the majority of modification proposals raised that have very little or no competition or consumer impact could be progressed via a self governance route, which would significantly speed up implementation of change identified as necessary by market participants. However, it is debateable whether an accurate assessment of any possible competition/consumer issues can be made at the very outset of a modification proposal, i.e. when the filtering decision is required to be made.

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, there is a case for retaining an improved Status Quo path, as the complex and potentially divisive nature of some Modification Proposals requires the additional benefits that Authority consent can deliver. The existing code modification process, particularly that which is set out in the BSC and CUSC, is more than capable of appropriately handling such modification proposals in an efficient and effective manner that delivers benefits to consumers.

Changes to the iGT Uniform Network Code to support Metering Competition are likely to need Authority involvement, given the significant commercial impact these changes will have on both iGT's and shipper/suppliers. Another example where Authority involvement is required is where a change to the Uniform Network Code (UNC) is being progressed under the User Pays Regime; challenges are likely with regard to how these modifications should be funded. The control framework provided by the Authority Consent process should ensure that users act in an appropriate manner when suggesting funding models.

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

The package of reforms should be applied to all codes to ensure that market participants and consumers reap the rewards of increased efficiency and reduced cost.

It would be advisable to phase the implementation of these reforms to Codes, to ensure that the change in Panel structures are supported by improved governance and change control processes. EDF Energy would recommend that change to Panel structures is implemented first in the BSC, then the UNC, and finally in the CUSC. Where practicable, code administrators should work together to ensure that the principles of self governance can be applied in a coordinated manner.

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?

The relevant panel should take the filtering decision and it would be best practice to encourage proposers to identify their preferred route on the Modification Proposal template. However we do not agree that parties should not be able to flag a Modification as suitable for Major Policy Review. This approach appears to create an asymmetric situation where parties who may be best placed to recognise an issue as

being suitable for a holistic programme of activity do not have a formal mechanism of triggering this process. This could be understood as an intentional device by Ofgem to prevent parties abusing a process which has the potential to demand significant resource and costs, but there does need to be some way of allowing parties to flag up to Ofgem matters of significance.

Question 2- What criteria should be applied to assessing whether a modification falls into Path One or Path Two?

We support the criteria set out within the consultation document.

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

Any modification raised during a Major Policy Review which is pertinent to the scope of the review should be “frozen”; i.e. they should not proceed through the standard modification process. The modification should be assessed by Ofgem to determine whether any of the constituent elements of the modification can be included within the review. Ofgem will need to ensure that the scope of any Major Policy Review is well communicated to market participants in advance of its commencement.

Chapter Four

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

We consider there to be fundamental flaws within the current proposals for a Major Policy Review path. The significant increase in regulatory control of the modification process under this path with no corresponding change in the existing regulatory checks and balances is not a proportionate response to the deficiencies identified. There is a real risk that this route could be used by Government/Ofgem to achieve short term political gain rather than strategic reform supported by robust regulatory impact analysis. The possibility of Ofgem becoming “judge and jury” on industry rule changes is entirely inappropriate, potentially damages market confidence and does little to improve the perception of market/regulatory risk over the longer term, which ultimately is detrimental to the interests of consumers.

An appropriately developed MPR path initiated on an infrequent basis as a result of major policy issues being identified by Ofgem or where market participants believe there is a requirement for a strategic programme of work could deliver real benefits, provided the concerns expressed above are addressed.

Question2 - What are your views on the Options for determining the outcome of a Major Policy Review?

As expressed above we have concerns regarding all three options to determine the outcome of a MPR and would prefer to assist with the development of a new option for determining their outcome rather than commenting in detail on the options in the consultation.

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

See above.

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

This is clearly dependant on which, if any, option is implemented. However, each option to a greater or lesser extent potentially undermines the existing appeals mechanism. Arguably, where modifications are raised simply to implement Ofgem's legally binding policy review conclusions, the opportunity for an effective appeal on the merits of the resulting code modification decision is questionable. With respect to Option 3, this risk is hugely significant, if it were to be progressed as currently drafted. Under this Option, in effect the network/code panels are to a large extent provided with a *fait accompli* and arguably are no longer providing a recommendation to Ofgem but simply expressing a view, in the knowledge that Ofgem will simply be deciding on its own modification proposal. Significant enhancements in regulatory accountability are required if any of the Major Policy Review paths are to be implemented. One such possibility would be to introduce some form of right to challenge the legally binding policy conclusions prior to any code modification being developed.

Ofgem will need to ensure that Code Parties and Consumer Representatives are provided with clear signposting when a Major Policy Review is going to be triggered. This will help to ensure effective engagement and liaison. There will need to communication above and beyond references within Ofgem's Corporate Plan to ensure that this active involvement can take place.

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

No, as this could frustrate incremental improvements to industry arrangements required post implementation. There needs to be a sensible mechanism which would prevent a regime being subject to significant overhaul in the immediate post implementation period, as this would subject the industry to unacceptable regulatory uncertainty while allowing for incremental improvements to be made.

Chapter Five

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

Super majority models should be taken forward across the Codes, as this will help to embed self governance processes. Code parties should vote in appropriate constituencies, e.g. Suppliers and Generators, Shippers and Transporters etc. For a self governance modification to proceed, success at an agreed level must be achieved in each constituency (i.e. 65% of code party's votes on a market share basis).

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

Panels should consist of Code Parties representing constituencies, e.g. supplier, generators etc., alongside an Ofgem and Consumer Representative. If there would be value in creating a "Small Participant" seat, then the party must be a Code Party and should have the same rights as other Code Panellists.

Question 3 What voting procedures should apply governing code decisions?

Representative party voting should be applied to all code modifications; for self governance modifications this voting should determine the outcome. Where Ofgem

involvement is required, party voting should be utilised, to assist with the Authority decision.

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

Appeal rights should be enshrined within industry codes and agreements; this gives parties to those codes a clear understanding of their rights and entitlements. Ofgem should not have discretionary rights in this regard, other than those of an administrative nature, e.g. an ability to request further information from appellants and other code parties in relation to the subject of the appeal.

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

Appeal rights are fundamental to self governance working effectively, but they should not be applied on an asymmetric basis. All parties entitled to vote on a change should be able to raise an appeal to Ofgem, if they believe the outcome of the voting process prejudices the objectives of the Code/Agreement.

Chapter Six

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

We support the 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?

The cost savings of the reform are based on numerous assumptions, all of which can be questioned. In particular Ofgem notes that undertaking a Major Policy Review would reduce the number of alternates and so the resources required. However gas exit reform (116V) gave rise to a total of four alternates, whilst the proposal developed by the industry only had one. Substitution is opposed by the majority of the industry, but has required two derogations and numerous workshops to progress. Transfer and trades had 18 modification proposals, which had a consequent effect on industry resourcing.

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

We agree that there will be positive effects on consumers, competition and sustainable development, as a result of the implementation of improvements to code arrangements. We would support a post implementation review to determine whether the intended benefits have been delivered.

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

The main risk under the Major Policy Review is that Ofgem uses the route to progress proposals that are opposed by consumers and market participants, such as DN Interruption reform. It is therefore important to ensure that appropriate checks and



balances, as described above, are in place on Ofgem to ensure that this route is not abused.

EDF Energy
February 2009