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27 February 2009

Dear Mark

Code Governance Review: Major Policy Reviews and Self Governance

If implemented these proposals would represent the most radical changes to Code Governance since the implementation of the new electricity trading arrangements (NETA) in 2001. In particular the suggested framework for both major policy reviews and self governance represents a significant rebalancing of decision making powers between the industry and Ofgem. Whether such changes would ultimately improve the efficiency and quality of code modification decision making is subject of some debate. In our view, it depends on whether the right checks and balances are in place to offset any enhancement or reduction in the rights and powers of Ofgem, Panels, individual market participants, customers and other relevant stakeholders. Any model that purports to offer "good governance" must also remain robust over the longer term. This surely means arrangements that are biased towards particular classes of market participants or to simply deliver what Ofgem wants, must by definition, lead to sub optimal outcomes.

We think it is right that affected parties and decision makers (whether customers, users, network businesses, Panels or Ofgem itself) should from time to time be unhappy with particular outcomes. In our view, if an organisation is consistently satisfied or dissatisfied with the process, it is probably not working properly. It is therefore important that individuals and the organisations they represent try to avoid being unduly coloured by recent experience of the code modification processes.

For a number of codes, outcomes seem to be unduly influenced by the relationship between Ofgem and the relevant monopoly network operators (the UNC and CUSC being the obvious examples). In this regard we welcome many of the ideas set out in the parallel code governance consultation on the Role of Code Administrators as these would attempt to place more emphasis on the interests of users and their customers. The self governance proposals in this document are also of significance in this regard.

Nevertheless we think that the apparent[1] absence of effective checks and balances on enhanced powers for Ofgem under the major policy review proposals (Path 1) could reduce both the quality of proposals developed in that process and the implementation decision.

Under the proposals Ofgem would:

- in effect be the originator of some key modifications proposals,
- act as a 'work-flow' manager categorising the 'importance' of industry proposals and allocating the level of industry/Ofgem resources to such proposals,
- prosecute its own proposals and
- make decisions on its own and most other proposals.

This is materially different from the current arrangements where Ofgem:

- indirectly originates proposals by (typically) encouraging[2] network operators to bring forward proposals,
- has important but more limited powers on the timetabling and urgency of modification proposals,
- does not generally advocate or promote[3] its preferred proposals during the modification process and
- always makes the final decision (which may be subject to a merits appeal).

Overall, the changes suggested in the consultation involve a significant shift in power and control over the code modification process towards Ofgem, but at the same time it offers an opportunity for the industry to have more say over a substantial number of (less 'important') proposals. Our main misgiving arises from the fact that Ofgem would be both the originator and decision maker for certain modification proposals. We think the Competition Commission view, expressed in its determination on UNC116V and UNC116A in July 2007, provides some useful guidance in this regard;

"However, it is less clear that the system of checks and balances established in the code modification procedures works if GEMA is, to use GEMA's words, the 'effective progenitor' of a proposal (or at least if it is perceived as such). The existing system envisages that GEMA will express a firm view as to what (if any) reform ought to take place at the conclusion of the process, rather than at the start of the process. If GEMA is the effective progenitor of a proposal, there may be a perception that it cannot fulfil its intended role under the UNC modification procedures without having prejudged, or at least appeared to prejudge, the matter." [Para. 6.192]

[1] The exact mechanism for implementation of "legally binding conclusions" is not set out in the consultation document although options are given.

[2] On occasions change may be mandated through a change to the relevant network operator's licence despite users having no direct right to formally object to such changes even though the impact on those users may be profound.

[3] Exceptions include the recent development of electricity cash-out proposals and the transmission access amendments.

The CC does not say Ofgem should not be able to originate proposals, but it clearly has concerns about checks and balances in the regime if they do.

In our view the existing code modification procedures do in fact permit implementation of major policy reforms in response to changing market conditions. We accept that these processes are not always perfect and can take time but we do not believe they have systematically failed. Ofgem already facilitates discussions where it considers gaps exist or more coordination is required and industry participants are never shy to bring forward proposals where Ofgem's views are aligned with theirs. Ofgem may from time to time be disappointed that its preferred[4] solution is not presented to it, but that is not grounds to say the process has failed.

Nevertheless we do acknowledge that there is one significant advantage to the suggested major policy review process and that is the 'origination process' would be much more transparent and open than bilaterally negotiated reforms[5] agreed between the relevant system operator and Ofgem over which users tend to have limited say. We would therefore be prepared to support Ofgem having the right to instigate major policy reviews if either:

(a) a merits based appeal was available to all code signatories immediately following the 'decision'[6] on "legally binding principles", or
(b) appropriate legal safeguards were established to ensure that any "legally binding principles" could not in any way constrain the availability and scope of the existing Competition Commission merits based appeal process.

It seems to us that, on the current proposals, the rights of code signatories to mount an appeal are challenged. The effect of section173(2) Energy Act 2004, and Article 4 of SI 2005 No.1646 is, effectively, to exclude from the right of a merits based appeal an Ofgem decision that agrees with the majority recommendation of the Panel. Therefore, it is essential to keep open the possibility that such a circumstance can actually arise and not create a situation where the "legally binding conclusions" of the review process actually themselves constitute the decisive act in the process, against which no merits based appeal will lie.

In Ofgem's Figure 1, at page 11 of the Consultation, the third box under Path 1 envisages that the Panel will develop a modification to comply with the "legally binding conclusions". As stated, it remains remotely possible that the Panel might develop a modification and then not recommend it, but the possibility of this must have been diminished by the fact that Ofgem has required them to take this step. However, we accept it does remain possible.

However, if additional steps have been taken by Ofgem that might constrain the Panel's ability not to recommend the "legally binding conclusions", this will undermine the legal possibility of

[4] E.ON and other companies have spent hundreds of hours over some 60 meetings in helping National Grid develop viable, practical solutions for new electricity transmission access arrangements, but these have not included the long-term auctions proposals that Ofgem favour.

[5] An example might be the entry and exit capacity substitution concepts that impact transmission users and their customers that was agreed ("binding principles") as part of National Grid's last Transmission Price Control Review (TPCR).

[6] The first could involve placing an obligation in the licenses of all code signatories (and not just the relevant network operator(s)). This would allow the normal statutory collective licence condition objection process to be followed, with a right for Ofgem to refer the matter to the Competition Commission should a blocking threshold be met.

any potential appeal. Ofgem seems to envisage exactly such a situation where it suggests at paragraph 4.20 of the Consultation that it might reflect the Major Policy review process in the code objectives, with a "code objective established governing the 'implementation and efficient discharge of Authority directions arising from a Major Policy Review". Since Panels do not have "free will" as such, but must operate in accordance with the particular Code objectives, this would have the effect of constraining the Panel only to operate in accordance with the "legally binding conclusions" – the Panel would in effect have no ability, or *vires*, not to recommend the ensuing modification. This would clearly thwart the will of Parliament to grant an effective appeal mechanism to Code signatories.

The Consultation does suggest (paragraph 4.21) that no change to the Code objectives may be required but this is on the basis of a belief that it is already covered – see paragraph 4.21 and paragraph 4.20.

Equally, Panel members should specifically not be bound to voting in favour of a particular proposal by virtue of their employing company being subject to a licence condition to bring forward a particular proposal (to give effect to the "legally binding principles"). In addition we do not consider that parties' rights to promote alternative proposals in the area covered by the major policy review should be limited. In many cases parties will see merit in some elements of an Ofgem proposal or may be in a position to consider alternative[7] solutions that better meet the key policy objectives. It would seem counter-productive to rule out these potentially better alternatives.

Put simply, there must remain the possibility, even under Path 1, that Ofgem's so-called "legally binding conclusions" are not legally binding and are not recommended by the Panel, so that the true decision by Ofgem is still taken AFTER the Panel recommendation, when it can be challenged on a merits basis, rather than at the stage after the review and before the Panel has to bring forward its modification.

Our detailed responses to the consultation questions are as follows:

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

We agree that codes need to evolve to deal with the challenges of climate change and security of supply. Recent discussions on Environmental Guidelines for example and in particular the work of the cross-code Standing Group established by the CUSC Panel show that the current arrangements and code objectives can accommodate can could reasonably permit assessment of environmental issues. The considered view of the Standing Group was that it was perfectly feasible for the CUSC amendment process to undertake an assessment of the impact of the proposal on GHG emissions under the "efficient and economic network operation" objective and

[7] Criticism is made of the recent series of electricity cash-out modifications that eventually led to the implementation of P217A. The thinking on these proposals developed following analysis produced for other modifications – we think it unlikely that the relevant knowledge would emerge any quicker through an Ofgem Major Policy Review because analysis and development of proposal is necessarily an iterative and evolutionary process.

that wider environmental assessments may be possible under the general code objective referring to "efficient discharge of the relevant licensee's activities".

However we are not persuaded that that there are fundamental weaknesses in the current structure or governance of industry codes. There are clearly many beneficial improvements that can be made to the codes and E.ON UK is keen to see where best practice can be identified, for this to be adopted more widely. In this regard we have put forward a number of ideas as part of the Code Administrators Workgroup that we believe will benefit all code signatories irrespective as whether they are large or small players[8].

We agree that the existing code modification processes have worked well for incremental reforms, but it has also proved perfectly possible to implement radical reform that has had a significant impact on market participants when there has been general support for change or change is championed by a particular player such as National Grid. The current arrangements were specifically designed allow code signatories and not regulators to propose changes and the current flexible governance processes facilitate 'evolution' rather than 'revolution' of the current market arrangements. More strategic public policy issues have traditionally been driven through implement the fundamental changes brought about by NETA and BETTA . Overall we think this is the right democratic framework for major policy reviews.

Ofgem refer to two specific examples where they believe the arrangements have been "severely tested" namely electricity cash-out reforms and electricity transmission access. These are equally a source of frustration for the industry but for different reasons. Ofgem may be disappointed that the cash-out modifications didn't deliver the proposals that they most favoured within the times-scales that they desired, or that the auctions are not the central theme of transmission access reform modifications but industry participants also get frustrated when they see apparent fundament changes in policy in a short space of time or they see viable proposals being rejected[9].

[8] For example we have stressed the importance of proposers retaining "ownership" of their proposals during the modification process as this gives proposer confidence that their proposal will be presented to Ofgem for decision without distortion. This clearly also relies on an effective process for consideration of viable alternatives that may be favoured by others to be considered in parallel.

[9] E.ON is puzzled by the apparent policy change in Ofgem's approach to electricity cash-out moving from support for near marginal cash-out price calculations (P194) to 'damped' cash-out prices (2117A) decisions with the space of 2 years. We understand that P194 originated from discussions between Ofgem and National Grid. The modifications that followed can be viewed as an exercise in mitigating the worst aspects of P194, and the most recent perhaps were about taking advantage of the shifting debate that seemed to favour more damped 'cash-out' prices. In hindsight we suspect most market participants would have preferred to stick with a pre P194 regime. The recent cash-out example could therefore be consider to be a good case study of the dangers of regulatory intervention and the perceived need to "do-something" whereas "do nothing" may have been the answer.

The industry has dedicated much time and resources to transmission access reform even before the Ofgem/BERR TAR process commenced. E.ON played its part in coming up with a number of the key user commitment concepts relevant to the interim final sums liability (FSL) arrangements. Despite providing a number of viable proposals that in our view clearly better facilitated the applicable CUSC objective, none of the CAP 131 proposals which were designed an enduring FSL arrangement were approved. It is clear from the Ofgem CAP 131 decision letter that this is because none of the options presented fitted with Ofgem's model for the future transmission access arrangements.

In E.ON's response on the scope to Ofgem's Code Governance review dated 22 January 2008 we did say that:

"*Streamlining code modification processes and focusing resources on high impact issues*[10] *would offer the best way of improving the quality of these important decisions. By allowing more routine matters to be dealt with by the industry under a form of self-determination, without reference to Ofgem, (other than allowing parties perhaps to appeal a decision), would provide Ofgem with more time to focus its resources and expertise on those code changes that involve more fundamental change and where industry agreement cannot be achieved."*

In this regard we believe the self-governance part of the proposals are very welcome and we think could provide significant benefits if some 50% of lower impact proposal could follow this route (as seems to be suggested by the back-casting exercise). This would allow Ofgem's resources to be concentrated on higher impact proposals that have more relevance to competition and market efficiency.

In our view the self governance piece (Path 2 and Path 3) is self evidently the right thing to do provided safeguards are put in place (e.g. the right of appeal to Ofgem under Path 3) and could be implemented relatively easily. As such we think it can be de-coupled from Path 1 (the major policy review piece) and we don't see why Ofgem is selling it as a package.

Currently a package without appropriate safeguards to maintain the efficacy of the Competition Commission merits based appeal under Path 1 is not, in our view, a very good deal. However, with the right safeguards under Path 1 E.ON would support this package.

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?

This depends on the circumstances. When there is a consensus on the need for change or a substantial proportion of market participants/relevant stakeholders consider change is required it could work as there would be a large body of opinion prepared to agree with any "legally binding conclusions". Where it becomes difficult is when Ofgem's views are at odds with the vast majority of the industry and other stakeholders and that is when it is important to ensure effective checks and balances are in place.

It is entirely right and proper for Ofgem to facilitate debate and this is already frequently done through reviews that do not form part of the modification procedures. For example the Ofgem cash-out and transmission access reviews provided an opportunity for a more holistic and structured debate and an environment that allowed more focused modification proposals to ultimately be brought forward. Adding the element of "legally binding conclusions" would however, have meant a policy decision being effectively made early on in the process - and the case of cash-out we think this would have required Ofgem to approve P211 (their original preference) rather than P217A based on entirely different principles.

[10] Those matters that profoundly affect the competitive market, involve material costs to individual code signatories and/or issues that (genuinely) require urgent attention.

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

Yes we think so. Real benefits will only be achieved if a significant proportion of proposals follow this route, and if this was to be around 50% as suggested by the back-counting exercise this would be very encouraging. There are doubts in some quarters however, whether Ofgem would really be comfortable in allowing this degree of self –governance. The appeal route to Ofgem is clearly an essential safeguard as is the opportunity for a full merits based appeal to the Competition Commission.

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?

Despite our hope for more self governance we believe that the majority of proposals will continue to follow this route. It is therefore essential to retain the current processes more or less as they are now.

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

We think it should be limited to UNC, CUSC and BSC, as it is these codes that could benefit most from more self governance. It is also likely that these codes will be more likely to be subject to a major policy review.

Many of the other codes that are perhaps more procedural in nature and already have a degree of self governance so it is probably less pressing to introduce changes to these codes. Our preference would be to start with UNC, CUSC and BSC and then potentially roll it out, if appropriate, to other codes based on any experience gained.

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?

Panels are in the first instance closer to the issues so are best placed to provide the initial view on categorisation. Thus we think the relevant panel should make the decision with a veto available to Ofgem.

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

Overall the criteria outlined in the document seem reasonable. Unfortunately like all criteria of this sort they can always be subject to creative interpretation. As far as possible we would favour tightening up the criteria that would allow the Path route to be followed; e.g. the intent to carry out such a review would have been signalled in advance for example in Ofgem's 5 year plan.

We think that once a proposal path has been determined it should be allowed to proceed through

that path through to the decision stage. This would provide certainty to the industry as to how it should allocate its resources. For example we would not like to see proposals elevated to Path 1 from Path 2 or from Path 3 to Path 2 half way through the process, although we can see it would be less problematic to go in the opposite direction Path1 to path 2 and Path 2 to Path 3.

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

During major policy reviews we do not believe that it is appropriate to have a moratorium on relevant proposals during the review. In many cases parties will see merit in particular conclusion of such a review or may be in a position to consider alternative solutions that better meet the key policy objectives. It would seem counter-productive to rule out these potentially better alternatives.

Another key concept we think is important is the each market participant whether large or small should have a right to have their proposal considered by a decision maker. A party might reasonably expect his proposal to be considered under the normal Path 2 route but it arouses the interest of Ofgem and is co-opted into Path 1 the proposal may not be taken forward. The legally binding conclusions that follow may effectively rule out implementation of the original proposal. Taking viable alternatives 'off-the-table' in this way would significantly diminish the rights currently enjoyed by modification proposers.

It is important that all proposals put forward at the start of the modification process are allowed to proceed to a decision at the end of the process and not be precluded by legally binding conclusions half way through the process. E.ON UK is for example strongly opposed to the "Connect and Manage" concept outlined under CUSC , but believe it is right that Ofgem be required to make a decision for or against this proposal.

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

All modification processes are currently overseen by the relevant Panels and tightly time-bound. It is unclear how these disciplines would be applied to Ofgem Major Policy Reviews - without such disciplines it is unclear why this Ofgem process would have advantages over the current modification process. It would be untenable if Ofgem were slow in coming to its conclusions and at the same time parties with solutions to issues were prevented from putting forward proposals because of a moratorium on modification proposals in a given subject area. Ofgem own internal decisions making processes would necessarily have to be as transparent and open as for example Panels are, which would require all relevant Authority papers to be published, modification business to be conducted in public and votes cast recorded.

All the "good governance" principles we are seeking to apply to the code should apply to the Ofgem Major Policy Review process. One could manage this by effectively having a process managed and chaired by the relevant Code Administrator, but with Ofgem setting out their views and objectives of any review.

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

The concept of legally binding conclusions seems to be at odds with the concept of making decisions at the end of the process. Options 1 and 2 seems to legitimise existing inappropriate practices whereby Ofgem place obligations on the relevant network businesses to bring forward proposals. This would be more acceptable if obligations were placed in the licenses of all code signatories (i.e. including network users). To get a third party to impose obligations on users in this way is inappropriate as those users have no right to object until the very end of the process through a costly appeal process[11].

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

We don't think it is feasible for Ofgem to be in a position to work up a fully drafted proposal (Option 3) without the help of the industry. However it does have merit because the originator (Ofgem) of the proposal would be absolutely clear. In the absence of safeguards that preserve the current scope of the merits based Competition Commission appeals process we would favour Option 3 - otherwise the processes set out under Option 1 and 2 might lead to an apparent legitimisation of proposals that industry participants might otherwise be reluctant to support.

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

This is the acid question and E.ON support for the Path 1 major policy review process is conditional on maintaining effective checks and balances within the process. We have set out suggested safeguards on page 3 of this letter.

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

No, a moratorium would restrict that ability of market participants to bring forward viable alternative proposals. Please also refer to the response given to Chapter 3 , Question 3 above.

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)?

Signatory voting perhaps offers the most efficient and democratic approach to code changes. It is perhaps most suitable the more procedural matters, but unfortunately it doesn't necessary elicit a clear rational for or against a particular decision as the reason for a voting for against does not have to be expressed. As such it is perhaps less suitable for many of the matters typically covered by CUSC, BSC and UNC where decision often turn on qualitative assessments of the impact on competition.

[11] Significant costs to customers could have been avoided if an effective right for users to object to proposals at this formative stage was in place.

We find the 'Independent' Panel model which is perhaps reflected in its most extreme form under the BSC to be the least satisfactory. The industry representative under the CUSC and UNC Panels tend to be closely involved in the code workgroups and therefore are well placed to make informed decisions. By contrast the BSC Panel tends to be more remote than the other Panels. Overall we think a representative model is more open and honest and certainly better than the partial decision made under the guise of independence. The highly unorthodox single transferable voting system under the BSC is particularly undemocratic as it delivers outcomes that do not properly reflect the electorate's preferences. In our view it should be replaced by a conventional single transferable voting system. A representative model with constituencies, e.g. similar to that suggested under Powergen's proposal P129 may also have merit.

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

It can be helpful to have a consumer representative but certainly it should not be mandatory. We doubt that customer representative would necessarily want to participate in many of the panels anyway. Overall we think that well informed customer panel representatives can be helpful and funding for customer advocacy may enhance the effectiveness of such customer representation.

The decision making for multi-user, multi-operator codes such as the UNC could be enhanced if this code included a voting customer representative instead of one of the transporter representatives. This would tend to mitigate the 'block-voting' tendencies of transporters.

It may be possible to design a constituency model that explicitly recognises small market participants. However we don't think the concept is necessarily that helpful. Gazprom are technically small players under the UNC and McAlpine and Fred Olson in electricity but no one could ever describe these players as small organisations. We therefore think that trying to bias arrangements in favour of "small" players is likely to be problematic and ultimately undemocratic. In any event we think the views that are typically held by "small" players in electricity are already well represented under the BSC and CUSC. As for gas under the UNC views are more likely to be split between producers and downstream players rather than based on size.

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

In theory it may be feasible signatory voting to occur but we accept that this may be more difficult under codes such as the CUSC, BSC and UNC, where one might expect the existing panel voting to applty.

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?

For any initial appeal to Ofgem we would favour the application of a disproportionate impact test similar to codes that already have self governance processes. If an appeal is allowed and Ofgem vetos the Panel decision a Competition Commission merits based appeal should be also be allowed. As theses right of appeal are set out in statute it would not be appropriate to seek to remove this right of appeal.

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

All affected parties should have equal rights of appeal for both Ofgem and the Competition Commission appeal processes. The later process being limited to decisions where Ofgem's decision does not concur with that of the Panel.

CHAPTER: Six

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

We are puzzled by the assertion that the Authority consider that "the current arrangements do not facilitate the delivery of major policy reforms in key strategic areas." We do not agree with this statement. As stated earlier Ofgem is has been able to facilitate reviews into major policy issues and has achieved this with respect to cash-out and transmission access. The important point to note is that the industry has brought forward viable proposals for each of these areas – it is therefore wrong to suggest the process has failed to produce the goods.

The self-governance proposals could represent a major step forward in improving the efficiency and effectiveness of the code modification processes, especially if say 50% of proposals could be dealt with under this route. We think Ofgem should be commended for its radical think on this matter. Nevertheless, we are aware that some parties including National Grid believe that only a relatively small percentage of proposals will be allowed to follow this route. Unfortunately recent history tends to suggest that despite the genuine intentions of the architects of certain codes (DCUSA and SPAA) fewer than expected proposals have been allowed to follow the self governance route.

We agree that the arrangements are complex and this makes it difficult for parties to engage in the process. This is a feature of the arrangements and we think streamlining and simplifying the modification process will benefit all players including small players and new entrants. The implicit prioritisation of issues under the three path approach will enable smaller parties with fewer resources to engage more effectively in the areas that are most important to them.

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

We agree the savings from avoiding dual assessment of Path 3 modifications could be substantial and the Ofgem costs savings suggested seem plausible. Some benefits will also be achieved through faster decision making.

We accept with the right drivers the Path 1 Ofgem Major Policy Review process could be quick and efficient. However unlike the current modification process this is unlikely be time bound and without such a discipline we fear that decisions make actually be slower than if modifications had followed the conventional Path 2 route. The recent painfully slow decision processes on

transmission losses perhaps illustrate what could happen.

The possible savings ascribed to cash-out are not in our view a good example. The saving referred to are not in fact savings as P217A simply resulted less revenue recovered from imbalance charges resulting in a corresponding reduction in residual cash flow (this is simply a redistribution of money from 'good balancers' to 'poor balancers' with no direct savings to customers). Arguably the risk management costs from less volatile charges mean that some cost savings might be seen by customers but this is hardly £37m per year.

In our view the cash-out prices provided by the P217A proposal are likely to be similar to that of the pre P194 regime. Avoiding this would have saved the implementation costs associated with P194. P210 and P217A which would have amount to several million for Elexon alone plus a the cost of changes to the systems of market participants. The assessment cost saving using Ofgem 's own figures alone would be around £0.5m. The cash-out example in our view illustrates the dangers of change for change sake and we would not wish the major policy review process to replicate this.

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

We agree that with the right checks and balances the three path proposal could offer very real benefits to customers improving both the quality and speed of decision making. The incorporation of Ofgem major policy reviews into the modification process offers a means of dealing with major policy issues in more coordinated fashion, offering the potential to streamline the process. If the major policy review process were to become simply a means for Ofgem to "take control" of particular issues and drive forward a particular agenda without due regard to the views of market participants and customers it will have failed. To realise real benefits for customers the major policy review process would need to be tightly time bound and the Authority decision making processes should be as transparent and open as the current industry code panels themselves.

Without theses safeguards these new arrangements are likely to lead to poorer quality and slower decision making.

SMART metering and facilitating distributed generation might be examples where the major policy review process could bring improvements. However we disagree that the examples cited by Ofgem (namely electricity cash-out and transmission access) demonstrate fundamental problems with the code governance regime. Far from bringing savings to customers the various implemented cash-out modifications (P194. P205 and P217A) and the numerous failed ones which came about following two Ofgem cash-out reviews, significant costs have been added to the industry. In addition smaller generators have been extremely active in transmission access review debate and in many cases the source of complexity that has been identified as problematic for such players arises from the desire of Ofgem pursue options not generally favoured by the industry (such as long-term auctions).

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

We think the self governance risks are small especially if there are effective rights of appeal to Ofgem and the Competition Commission. The greatest risk, in our view, arises from inadequate checks and balances under the Path 1 regime. The process will not work if the "legally binding conclusions" that arise from any major policy review were to limit the scope of any merit based Competition Commission appeal. In addition the suggested processes for co-opting proposals from Path 1 to Path 2 or a moratorium on proposals during such a review could unreasonably limit the right of parties to bring forward credible proposals.

The greatest risk seems to be orgination of highly theoretical proposals that are difficult to develop in practice. New Ofgem powers to originate proposals direct resources and effectively control all three paths (which path taken or change of path), a moratorium on proposals, the timetable for any policy review and new 'call-in and send-back powers reduce the industry's say and influence. If parties conclude that their role is secondary or simply just about implementing the will of Ofgem they will simply become less active in the modification process. We fear that this could ultimately reduce the quality of modifications developed in the process.

Please feel free to give me a call if you wish to discuss the views set out above

Yours sincerely

Peter Bolitho
Trading Arrangements Manager