

1<sup>st</sup> Floor South  
31 Homer Road  
Solihull  
West Midlands  
B91 3LT

**Telephone No:** 0121 623 2115

**Fax No:** 0121 623 2113

**E mail:** [enquiries@gasgovernance.com](mailto:enquiries@gasgovernance.com)

**24 Hour gas escape  
number 0800 111 999\***

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and may be monitored

Mark Feather  
Director Industry Codes and Licensing  
Ofgem  
9 Millbank  
London  
SW1P 3GE

27 February 2009

Dear Mark,

## **Code Governance Review: Major Policy Reviews and Self Governance**

The Joint Office of Gas Transporters (JO) welcomes the opportunity to comment on Ofgem's Consultation Paper *Code Governance Review: major policy reviews and Self Governance*. The views in this response are those of the JO and, for the avoidance of doubt, I can confirm that Gas Transporters have not sought to influence or approve this response. Views on the specific questions raised in the Consultation Paper are included as an appendix to this letter. The views expressed necessarily focus on experience with the gas Uniform Network Code (UNC) – we have no direct experience of other codes on which to draw.

The JO can see both risks and benefits in moving to an approach which incorporates both increased self governance and coordinated, Ofgem led, major policy reviews. However, our experience of the UNC modification process often supports the old adage that "the devil is in the detail" - we believe this applies to the design of both self governance and major policy reviews and that the balance between risks and benefits is crucially dependent on the detail of the proposed approach.

### **Self Governance**

The JO supports increased self governance, which provides an opportunity for a more efficient process for dealing with a number of change proposals. Perhaps the most important detail which needs to be addressed, and has the potential to be controversial, is the decision taking process. The present UNC Panel has balanced voting rights with an equal number of votes allocated to Transporters and Shippers. The Transporters appoint their own voting members, while Shipper voting members are elected through a process which the Gas Forum administers on their behalf. The

UNC Modification Rules also provide for non-voting members to represent Terminal Operators, consumers, small Suppliers, independent Gas Transporters and Ofgem.

The decision as to whether or not this is an appropriate model for increased self governance is likely to influence other matters which have been raised in the course of the Code Governance Review. For example, if it is concluded that all parties should be able to vote on whether or not a change is implemented, the role of the Panel would be very different to that when the Panel is the sole decision taking body. Equally the nature of any appeals mechanism and the definition of restrictions on when an appeal may or may not be allowed is likely to be dependent on the way in which decisions are taken.

From a code administrator's perspective, we would be happy to support any decision taking process which commands widespread industry support. That said, we believe that there are advantages in retaining a Modification Panel as the key decision taking body, including determining whether or not Proposals subject to self governance should be implemented. Taking decisions at Panel meetings provides an opportunity for issues to be debated and clarified in order to help Panel Members determine whether or not to support implementation of a particular proposal. Importantly, this debate is not restricted to Panel Members - all UNC signatories are entitled to attend Panel meetings. All attendees are welcomed and non-members can, and do, provide valuable insights to issues. While this ability to influence decisions already extends to consumer representatives, the JO would have no objection to consumer or other representatives of smaller parties being entitled to vote at Panel meetings. We are aware that some customer representatives have suggested that the lack of a vote at Panel meetings devalues their attendance and therefore believe that an extension of voting rights to consumer representatives would be valuable to the extent that it encouraged involvement in the modification process and helped to ensure that the consumer viewpoint is heard and understood. However, if a balanced Panel is retained – with an equal number of Shipper and Transporter votes – it would seem sensible to exclude any other votes when the self governance path is followed. This is because these proposals should, by definition, have no material customer impact and it would be inappropriate to potentially give a consumer representative a casting vote.

Relying on a Panel process for decision taking also has the benefit of providing a speedy, transparent, simple and unambiguous process in most circumstances. For self governance, we would suggest that in the event of a tied vote, there would be merit in all such Proposals being automatically referred to Ofgem for decision. In effect, this would transfer self governance proposals to the status quo path at the final, decision taking, phase.

## **Major Policy Review**

We welcome the suggestion that a formal major policy review process should be introduced. Experience has shown that the UNC modification process tends to operate most effectively when dealing with relatively well defined and understood issues and where major policy issues do not need to be resolved. The effectiveness of the UNC modification process is reduced when implementation of a Proposal depends on changes which extend beyond modification of the UNC.

Difficulties in coordinating and managing change processes have arisen when a change proposal is developed through a series of independent processes with

different parties responsible for different parts of the process. For example, Ofgem might initiate a consultation process, typically as part of a price control review. Implementation may then involve licence changes (proposed by Ofgem and accepted by licensees); development of documents which sit under licences (proposed by licensees and accepted by Ofgem); and modification of the UNC (proposed by a UNC party and approved by Ofgem). When the detail of all these strands is worked through following the required governance process, this can lead to a conclusion that some of the starting principles might beneficially be flexed. However, this is particularly difficult when principles have been enshrined in licence changes as part of a price control review outcome.

We would therefore very much welcome a process which allows the necessary changes to be progressed in a single holistic process, avoiding overlapping and differing consultation processes and delivering a single decision point which simultaneously directs implementation all of the elements of a change proposal as a package. While this can be applied in the context of major policy reviews, it would also be of value on a regular basis, for example when changes to charging structures are introduced which require both code and charging methodology changes or, to take a recently introduced arrangement, for changes to Code User Pays services and charges (as specified in the Agency Charging Statement) to be managed through a single process.

A key implication of this view is that the ideal outcome of a major policy review as envisaged in the consultation paper should be a fully worked up and comprehensive package of changes which is complete and ready for implementation. This should help to avoid the difficulties which can emerge if developing the detailed supporting rules is detached from the high level policy decisions. However, experience has shown that flexibility is valuable and we believe that provision should also be made for less prescriptive directions to be issued by Ofgem as the outcome of a major policy review. However, as far as possible the intended outcome should be specified at the outset of any major policy review – i.e. it should be clear whether Ofgem is going to lead development of a detailed package which is to be fully specified and implemented as a package (subject to appropriate safeguards on appeals etc), or if the intent is that Ofgem will signal the direction in which they believe policy should be developed, leaving it to industry to both develop the policy and the way in which it is, if at all, implemented. We believe this could be achieved by allowing Ofgem to raise change proposals to modify codes which, in effect, would follow one of the three routes available under the present UNC Modification Rules:

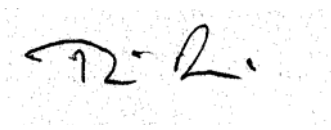
1. Review – a proposal which looks at an area and considers whether change is desirable, with a draft change proposal being one potential outcome of the review process.
2. Development – a proposal which indicates that change is desirable and establishes a clear direction of change, but which needs developing to define the precise nature of that change proposal and how it should be implemented.
3. Consultation – a fully developed change proposal which is not to be further changed and on which views are to be formally sought.

The key safeguard, which we believe should be implemented as part of a major policy review process, is to ensure that Ofgem is not both the raiser of a proposal and the body which decides whether or not it should be implemented. Our view is

that Ofgem should be able to raise change proposals as the outcome of a major policy review, but that any such change proposal should be subject to the standard self governance process for deciding whether or not it should be implemented. As for other self governance decisions, this would be open to appeal to the Competition Commission, irrespective of whether the implementation decision did or did not support the Ofgem view. There would be merit in considering whether, in these circumstances, Ofgem should be allowed an automatic right of appeal where the self governance route does not support the outcome proposed by Ofgem following a major policy review.

We hope these comments are helpful and, as always, would be happy to discuss or elaborate on any of the points raised.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'T. Davis', is centered on a light grey, textured rectangular background.

Tim Davis

Chief Executive

## Code Governance Review: Major Policy Reviews and Self Governance

### Appendix: JO Response to Questions Raised

#### 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?*

While we recognise the deficiencies identified in the Consultation paper, we would recommend taking a cautious approach to reform. In some circumstances, the deficiencies identified could be seen as strengths of the change process – for example, multiple change proposals being raised on key policy issues may be seen as a positive sign of competitive thinking, with parties substantively engaged in a development process who are willing to bring forward their own preferred solution in the absence of a common view regarding the best way forward. The UNC has been subject to substantial modification since its inception in May 2005, with direction to implement 131 Modification Proposals having been received. Modification Proposals have been raised by 21 separate parties. This level of change and the extent of involvement in the change process suggests that, at least for most circumstances, the UNC change process is working. We therefore believe that any moves to reform the approach should tend towards evolution rather than revolution. As such, there is a risk that the change proposals outlined in the Consultation Paper may prove not to be proportionate and a careful assessment should be made of likely costs and benefits prior to implementation.

In this context, it is worth considering whether the deficiencies identified in the Consultation Paper are likely to be addressed by the proposed reforms. The Consultation Paper suggests that *“The delays and difficulties that have been experienced have been caused by a variety of factors including:*

- *multiple proposals being raised on key policy issues;* (This could be addressed if the reforms incorporate a prohibition on the raising of formal change proposals which were judged to be within the scope of an Ofgem major policy review. However, it is unlikely that this would prevent change proposals being put forward for consideration during the review, albeit not as formal change proposals, and hence any benefits at this stage of the process would be limited. However, if the prohibition extended until any proposal emerging from a major policy review had been implemented, with the prohibition preventing alternatives being raised, this would address the detriment albeit at the cost of potentially stifling competing ideas and solutions. It is also worth considering whether any such prohibition which prevented the consideration of alternatives might increase the likelihood of the Competition Commission appeal process being relied upon, thereby outweighing the benefits offered by the proposed reforms in some cases.)
- *duplication of assessment processes, with assessments being performed by Ofgem, code panels and industry participants;* (Increased reliance on self governance would help to address this detriment since it would potentially remove Ofgem assessment of a number of change proposals. The proposed reforms could also help to address duplication in the case of major policy reviews by bringing all assessment into a single process. This would, however, leave potential for continuing duplication in many cases and we believe there would be merit in considering further reforms to address this issue. Change can often involve a number of processes and documents and it would be beneficial to streamline the processes involved in order to deliver holistic consultation and decision processes.)
- *piecemeal development of proposals, with proposals often being raised on similar issues several months apart;* (It is not clear how the proposed reforms would address this issue. We would also observe that, in some cases, rather than representing piecemeal development, the raising of related change proposals several months apart could be seen as learning from experience. Similarly, implementing change through a series of incremental proposals rather than a single change can be beneficial. In particular, there can be advantages in discrete change proposals being put forward for consideration as self contained changes rather than necessarily being part of a larger suite of changes, such that all parties – including Ofgem –



can take a view on which of the particular elements should be supported rather than necessarily needing to support or oppose the whole of an integrated change proposal.)

- *cross-code and code/licence/charging methodology coordination issues;* (Other than in the case of major policy reviews, the proposed reforms do not address this detriment. For major policy reviews, only one element of coordination is potentially addressed by the proposed reforms which seek to bring policy development into a single process. However, once the Review is complete and change proposals are progressed through differing routes – under the appropriate code or licence governance provisions – the coordination is lost. We believe the key to addressing this issue lies in developing an holistic approach which supports the coordination of these types of change, which are relatively common, irrespective of whether or not a major policy review is undertaken. This would involve defining a coordinated development, consultation, decision and implementation process covering all the codes impacted as well as any licence change or amendment to a licence related document – such as charging methodologies.)

- *divergences in the commercial interests of different players, some of whom may be opposed to reform.*” (Quite properly, the proposed reforms do not address this issue. While positions will be influenced by commercial interests, it is a strength of the existing change processes that they encourage parties to come forward with change proposals which have the potential to develop the way in which the industry operates. It is also quite proper that parties should have an opportunity to express and explain their positions with regard to any proposed change.)

**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?*

We believe that, if carefully designed with appropriate obligations and safeguards, there is potential for major policy reviews to be progressed more effectively and efficiently through a major policy review process, and we support its introduction. However, it is not necessarily the case that this benefit would be delivered in practice simply by introducing a major policy review process. Arguably the approach has already been used in a number of cases and the Code Governance Review is looking to further legitimise following a process in which Ofgem takes a leading role, such that no significant benefits could be expected in terms of efficiency or effectiveness since there would be no practical change. To take an informed view of the likelihood of change being more effective and efficient under a new process would require a clearer exposition of the approach which is proposed and the way in which it will be implemented, making it clearer how this would differ from practice seen to date. It is inevitable that the detail of precisely what is proposed is important in this respect. For example, if Ofgem were to set a clear timetable for completion of a major policy review, including implementation, and then all steps and analysis were undertaken in line with the strict timetable, there is every prospect of shortening the time taken to develop change proposals. However, this would not be easy to deliver in practice – experience to date suggests that there have been occasions when Ofgem has not been able to achieve promised deadlines.

In addition to commitment to a clear timetable, such that any process is time bound, if a key benefit of implementing major policy reviews is intended to be a more efficient and effective process, consideration should also be given to how Ofgem conclusions are shaped and implemented. A possible outcome of a major policy review could be a fully formed change proposal which Ofgem would direct should be implemented, with no need to follow any of the existing code governance processes. By providing for more direct implementation of decisions, this could be seen as a more efficient and effective process – although not one which we would support since we do not believe it is appropriate for any party to be able to both raise a change proposal and be able to decide whether or not it should be implemented.

If the outcome of a major policy review were publication of some general principles which Ofgem required the industry to follow and develop into a suitable change proposal, it is not clear that the proposed approach should be expected to be more efficient and effective. Experience in the case of gas has indicated that where Ofgem set out in Licences broad expectations regarding development of specific areas, progress is not necessarily quick. For

example, recent experience has revealed difficulties in developing the User Pays approach to funding some systems costs (the key building blocks to implement this approach are not yet in place despite Ofgem's aspiration that it should be complete by April 2008). Entry capacity substitution provides a further example, with work continuing to define and implement this element of the Transmission Price Control Review some two years after the start of the price control period. For any revised approach to prove more efficient and effective, we would therefore contend that it is essential for the outcome of any major policy review to be prescriptive and unambiguous. Within the UNC context, this could be achieved by Ofgem raising a Modification Proposal and acting as the Proposer for the purposes of the change process. This could involve Ofgem providing a fully worked up change proposal, which could then be issued directly to consultation and follow the self governance route (thereby avoiding Ofgem both raising a change proposal and deciding whether or not it should be implemented). Alternatively Ofgem could establish in a change proposal a set of clear and achievable boundaries within which a detailed change proposal can be developed with industry parties, following the existing Development process – with Ofgem, as Proposer, deciding which elements it did and did not wish to incorporate within the change proposal.

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

We would welcome sight of Ofgem's assessment regarding which historic change proposals might have been appropriate for self governance. While accepting that judgements about the suitability or otherwise of specific proposals is subjective, we would anticipate that most industry players would identify a significant proportion of change proposals as being suitable for self governance, with a large degree of consistency in terms of the identified proposals. Our own assessment of UNC Modification Proposals raised in 2008 suggests that approaching 50% may have been appropriate for self governance. If self governance is to be introduced, however, we would expect consideration to be given to the way in which decisions are taken and to how any appeal process might work, and the outcome of these considerations may affect the range of change proposals which is subject to self governance.

**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?*

Irrespective of the implementation of increased self governance and/or major policy reviews, we believe there is a case for retaining and improving the Status Quo path.

**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 do not believe that it is necessarily appropriate for the same package to be applied to all codes. We would suggest it is appropriate to consider the reforms in the specific circumstances of each code but that there should be a presumption in favour of consistency – the onus should be on making the case for a different approach to be applied rather than needing to make the case for a generic approach to apply.

### Chapter 3

**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?*

We believe it would be appropriate and efficient for the initial decision to be taken by a panel as to whether to follow path 1 or 2, with a time-limited option for Ofgem to determine a major policy review should be instigated. This would be a straightforward process which should not add to existing timelines, with this being one of the decisions taken by panels when a change proposal is first presented. We would propose a more open opportunity for Ofgem or the relevant panel to subsequently determine that a change proposal initially allocated to Path 3 should become a Path 2 proposal (we do not believe a move in the other direction should be allowed).

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

We believe that flexibility is valuable and that panels should be given discretion to decide which change proposals should fall into which path, but that general guidelines should be

published to inform that decision. The suggestions in the consultation document provide a good foundation for such guidance.

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

The UNC Modification Rules provide for a view to be sought from the authority as to whether or not a Modification Proposal should proceed. We would suggest building on this process by allowing for the Authority to direct, either following or without an application, whether a Proposal falls within the remit of a major policy review and so should not proceed under any other governance process. Hence any such Modification Proposals would be deemed to have lapsed and any consideration of the issues involved would be progressed within the major policy review framework.

## Chapter 4

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

Consistent with our view that flexibility is desirable, we would suggest that the process should not be set in stone but should instead be established to suit the circumstances, including urgency, of each issue. Having said this, we would see value in following a process similar to a price control review, with consultations on the various issues and a set of initial and final proposals followed a final formal consultation on the proposed changes to the codes and other documents involved.

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

We believe two routes are possible and the outcome should be either very specific and binding – all the detail would be complete and the outcome a full proposal, which would not be open to further development; or a conclusions document which identifies a problem and suggests some parameters for taking the matter further, but is non-binding and open to development.

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

Implementation would be dependent on the nature of the outcome. However, we believe that implementation should follow the standard processes as far as possible, with Ofgem being the proposer of change proposals.

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

We would suggest that an important general safeguard is to ensure that the body which is the decision taker is not also the proposer. Given this, for any proposal to change a code which emerges from the major policy review process, it would be appropriate for the panel to be the final decision taking body – effectively the change proposal would become subject to self governance at the final stage. Allowing Ofgem, in addition to other parties, to appeal to the Competition Commission would also be a worthwhile safeguard.

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

We do not believe that it would be practical to implement a moratorium.

## Chapter 5

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

As a code administrator, we would be happy to work with any model which the wider industry supports.

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

We do not believe that this should be mandatory for all codes, but consistency across similar codes would be valuable.



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

As a code administrator, we would be happy to work with any voting mechanisms which command industry support.

**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?*

We believe that it would be appropriate to develop a model based on that used for appeals to the Competition Commission, which seeks to avoid vexatious appeals.

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

We do not believe a case has been made that supports this.

## Chapter 6

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

We agree with the assessment of potential benefits that may be delivered against the Review Objectives. However, whether or not these are delivered in practice is crucially dependent on the detail of the proposals which emerge from the Code Governance Review. For example, the Consultation Paper appears to be written on the basis that an outcome from a Major Policy Review would be a change proposal which would be progressed through the appropriate industry change process – if this is correct, it is not clear how the proposed approach would necessarily avoid multiple assessment processes nor reduce the timeline associated with implementation.

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

See above. The impact will be dependent on precisely what is proposed and how it is implemented.

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

Yes – we agree with the potential impact. Again, however, the design of the proposals will influence whether or not this potential is realised.

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

While agreeing with the risks, we believe there may also be an additional risk that Ofgem may be encouraged to bring increasing numbers of issues into the Major Policy Review category and hence that industry change will become dependent on Ofgem's resources and priorities. There could be a significant risk of Ofgem acquiring too much control over the industry change process, especially if Ofgem both sponsors proposals and decides whether or not they should be implemented – the balance of checks and balances in the present system could be fatally undermined by the Major Policy Review process.

Self governance carries a risk of complexity and consequent cost if industry participants conclude that relatively complex decision taking processes are justified to provide checks and balances for self governance decisions. There is also a risk that substantial resources will be devoted to designing a self governance regime through which only low value proposals are assessed such that the implementation costs may never be recovered.