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25th February 2009

Dear Mark

Code Governance Review: Major Policy Reviews and Self Governance

Thank you for the opportunity to respond to the consultation regarding Major Policy Reviews and Self Governance. This response is on behalf of National Grid Electricity Transmission (NGET) and National Grid Gas (NGG). NGET owns the electricity transmission system in England and Wales and is the GB System Operator. It is responsible for administering the electricity Connection and Use of System Code (CUSC), the Grid Code and the System Operator – Transmission Owner Code (STC). NGG owns and operates the Gas Transmission System and also owns four of the Gas Distribution Networks. In association with the three other gas Distribution Network Operators we also jointly provide for the administration of the Uniform Network Code (UNC) Governance arrangements via the Joint Office of Gas Transporters and operation of a number of key systems (including the Supply Point Register) via our agent xoserve.

We are supportive of the proposals to address the issue of how to approach wide reaching policy issues that cut across industry codes and licences. The three Path model offers a mechanism to address this issue and, in reality, will formalise the existing practice, whereby Ofgem encourages market participants to raise modification proposals to facilitate the debate, (for example, transmission access). In addition, it will provide Ofgem and the industry with the ability to prioritise strategic work areas, debate issues and refine ideas prior to the commencement of formal code change governance processes.

For Path 1 to be effective, all industry codes and licences need to be within scope but other Paths may not be suitable for all codes, in particular the technical codes (Distribution and Grid Code) and the STC in light of the current developments regarding the new Offshore arrangements which are due to commence this summer. However, the proposals should not in themselves seek to force fit a uniform approach to governance across all codes as the current differences have evolved due to the individual nature and effect each code has on the industry.

In order to avoid regulatory uncertainty, further clarification and detail is required to understand how the three Path approach will work in practice. In particular, we believe criteria needs to be established detailing the conditions under which Ofgem is able to instigate a Major Policy Review (MPR), as an industry participant needs to be able to assess whether its proposal is likely to trigger a MPR. In addition, a high level process framework needs to be established to ensure that the industry understands how the MPR process will be conducted including a plan prior to the commencement of the review to ensure effective consultation with all interested parties. We also agree with industry members who suggested a MPR strategy should be detailed in advance (two/three years) within Ofgem's Corporate Strategy.

We do not believe Ofgem's role should be expanded to include the ability to raise code modification proposals. The current arrangements allow Ofgem to demonstrate its independence from the detailed development of code modifications with the appropriate restriction of its role to code modification decision making. From the three options considered within the consultation, we believe that high level binding conclusions would allow the industry the necessary flexibility in development via the "normal" Path 2 process. However, we have concerns regarding how the obligations will be enforced. If a Network Operator's licence included obligations to raise modification proposal after a MPR, this may adversely impact its ability both to contest the modification proposal during its development and to raise an appeal to the Competition Commission. As a consequence, we require further clarification on how this would operate in practice.

We believe that the filtering process requires additional clarification as it is too broad as currently described. We also believe that Ofgem specification of all Paths for all code modification proposals would be both impractical and place an unnecessary administrative burden on Ofgem. A more proportionate approach would be for the Panels to apply the filtering criteria and determine the appropriate Path for all modification proposals and for Ofgem to have the right to veto the Panels' decisions.

A moratorium period following a MPR is impractical and is inconsistent with the current principle that any code participant can raise a modification at any point. Experience to date also demonstrates that many major code changes require further refinement subsequent to their implementation. A moratorium period during the MPR appears sensible, provided that there is an exception process to deal with situations where, for example, a proposal could prevent significant financial loss for the proposer and the MPR will not conclude in time to prevent such a loss.

An extension of the current self governance areas within the codes may provide further benefits to the industry subject to the appropriate checks and balances, such as the ability to re-classify modification proposals from Path 3 to 2 and a merit based appeals process to Ofgem for all code participants. In order to achieve maximum benefit we believe that any extension of the current self governance processes must be simple, clearly understood and that the Panels should be appointed as decision makers.

However, we disagree with Ofgem's view that approximately half of the modifications for the major commercial codes (BSC, CUSC and UNC) would be processed via Path 3. We believe that the types of modification proposals progressed via self governance will be housekeeping and simple business rule changes. We believe that it is important to fully understand the implications of any wider definition of Path 3 modification proposals, as a number of "innocuous" looking modification proposals can have large implications for some market participants. As a consequence we believe that there is merit in exploring such implications further.

In summary, we support the proposals in principle and with further clarification and explanation they should facilitate and better prioritise major policy changes within the industry.

A detailed response to the questions raised within the consultation is attached in the Annex to this letter.

If you wish to discuss this further or have any queries please do not hesitate to contact me or, Mark Ripley on 01926 654928, mark.g.ripley@uk.ngrid.com, or Richard Court on 01926 656146 richard.court@uk.ngrid.com.

Yours sincerely

[By e-mail]

Paul Whittaker
UK Director of Regulation

Annex – Question responses

Chapter 2

- 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?**

National Grid raised the issue of the development of large scale and/or broad changes which cut across two or more codes and licences in our response to Ofgem's Scoping of the Review open letter in January 2008. The relevant extract from our response is set out below below:

"We are concerned with the issue of the development of large scale and/or broad changes which cut across two or more industry codes and licences, such as DN Sales and Access reform. The associated governance arrangements that work well for assessing incremental changes and/or discreet packaged changes can start to struggle to accommodate and take account of such wider complications or fundamental changes. In the future a more flexible framework may be appropriate which can adapt to increasing complexities and external influences such as developments to the regulatory regime in Europe. Consequently, we believe that the need for codes to have the ability to consider cross functional issues and / or implement wider/wholesale industry projects should also form a major part of the scope of this review."

We remain of the view that the deficiencies described above exist and that Ofgem's assessment is broadly correct. We agree that the regulatory and market landscape is changing and that issues are becoming more strategic, wider reaching and are more frequently driven by public policy.

The gas and electricity industries are complex and we understand the difficulties that the scale of the industry places on small participants and new entrants. As such, there is always merit in exploring avenues of improvement to the governance arrangements, such as the proposals contained within the consultation. However, the proposals will not reduce complexity regarding technical or market mechanism issues, as the issues and consequential impacts will not become any less complex or easier to address.

In summary, we believe that the proposals are proportionate and will in effect formalise existing practice, whereby Ofgem encourages market participants to raise modification proposals to facilitate the a MPR (for example, transmission access).

- 2. Would the Major Policy Review (MPR) 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?**

MPRs should allow for a holistic approach to be taken where an issue impacts across the industry and should prevent an inefficient piecemeal approach to change. However, the time and cost savings may not necessarily be as significant as anticipated, as the issues and consequential impacts will not become any less complex or easier to address. Therefore, a MPR will still require a significant amount of industry time and resource to develop detailed solutions.

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

Further to our review of the modifications made to the UNC, CUSC and BSC within the previous three years, we disagree that approximately 50% of modification proposals could have been managed through a self governance route. As stated within our letter, we believe that the majority (circa 90% for UNC and 85% for BSC, CUSC, STC and Grid Code based on historic data) of modifications will follow the "normal" process, Path 2.

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

We believe that no compelling arguments have been articulated for change in the operation of the “Status Quo” path and that it is not only a requirement but a necessity for the “normal” process to remain. However, there may be opportunities for improvement and the appropriate sharing of best practice between different codes. MPRs should only be undertaken in limited circumstances (i.e. where an issue has significant cross code and licence implications or relates to an area of public policy) and, in our opinion, self governance will be limited in scope to housekeeping and simple business rule modifications. The majority of changes will, therefore, follow the ‘business as usual’ Path 2 process.

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

The MPR (Path 1) process needs to be applicable to all codes to ensure fundamental / major strategic changes can be considered in a co-ordinated manner. However, the adoption of the Path 2 and 3 approaches (and in particular self governance) may not be appropriate for all codes. In particular, at this time we do not believe it is appropriate for the technical codes due to their nature, i.e. only network operators can raise formal changes, the panels do not provide recommendations as the Panels strive for consensus and there is no appeal to the Competition Commission. In addition, the adoption of Paths 2 and 3 should not yet be applied to the STC as the scope of the STC is likely to change considerably when the new Offshore regime is implemented. This should be further reviewed once the Offshore arrangements have been implemented.

Chapter 3

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

We consider that it would be impractical and place a disproportionate administrative burden and cost on Ofgem to undertake the filtering process for all modifications for all codes. We believe that once a filtering process has been clearly defined, the Panels should determine the Paths for all proposals with an Ofgem right to veto this decision within 15 days. This would provide a more efficient process, is consistent with Panels’ other duties and Ofgem (as an attendee of all Panels) has the ability to express its views at the time a modification proposal classification is debated at the relevant Panel.

Finally, to avoid regulatory uncertainty, the grounds upon which Ofgem can veto a Panel decision must be clearly defined and specified as part of the filtering criteria.

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

National Grid agrees with the principles behind the criteria described within the consultation for Path 1 and 2. However, further clarity is required to fully understand how this would work in practice. For example, what constitutes a “significant impact?” This could mean different things to different participants as modifications do not always affect all parties in equal measure. In addition, the broadness of the current criteria could create uncertainty for those cases which are “borderline”. We also believe that criteria must be developed to clarify the circumstances in which Ofgem is able to raise an MPR without being triggered by a modification proposal.

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

We support a moratorium during a MPR subject to the development of appropriate checks and balances. This should include the ability for modification proposals to be raised by exception (similar to the current urgent process). An example could be where the proposer can demonstrate that the MPR process will not conclude in time to prevent significant financial loss for the proposer or there is a previously unknown date related event that has come to light during the course of a MPR.

However, a moratorium period following a review is both impractical and inconsistent with the principle that any code participant can raise a modification proposal at any point when they perceive there is a defect with the prevailing arrangements. Experience also demonstrates that many major code changes require further refinement subsequent to implementation.

Chapter 4

1. What process should be adopted for Major Policy Reviews?

We broadly agree with the process described within the document and believe that both licence and code changes would ordinarily be required to implement the proposals arising from a MPR. MPRs should be able to be triggered by either Ofgem or by a modification proposal which falls within the defined filtering criteria. In addition, we believe that a high level process framework needs to be established and Ofgem's intended MPR strategy areas be published in advance (two/ three years) in its Corporate Strategy document.

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

We do not believe Ofgem should have the ability to raise code modifications proposals. From the remaining two options it is unclear what the difference between high level and detailed conclusions would be. However, on the basis of the high level conclusions being similar to the recent TAR conclusions, our preference would be for non-binding conclusions to ensure flexibility during the modification proposal development process. Therefore, the development of high level binding conclusions, which allow for flexibility and development by the industry through the "normal" modification proposal process, is the most proportionate option. We believe it would be useful for Ofgem to provide further clarifications, by way of example, regarding the content of such conclusions.

In addition, we are concerned and request clarification as to how the obligations relating to such conclusions would be enforced? If a Network Operator's licence included obligations to raise modification(s) after an MPR, this may impact its ability to contest the modification during its development and to raise an appeal to the Competition Commission. As a Network Operator, National Grid would, therefore, require greater clarity as to how this might be achieved without diluting its ability to oppose a proposal or refer a decision to the Competition Commission.

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

See response to question 2 above.

4. What safeguards and appeal mechanisms should be in place?

We agree with Ofgem that an additional right of appeal is not necessary. However, a full merit based appeal to the Competition Commission needs to be assured and not restricted by the outcomes of an MPR or the implementation of the subsequent modifications due to licence drafting. As discussed at the industry meeting on 11th February, we also see merits in allowing an appeal to the Competition Commission on the merits of a MPR conclusion.

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

See response to Chapter 3 question 3.

Chapter 5

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

Voting by code signatories (constituency voting) can be complex, costly and time consuming (for example the current DCUSA voting process). As a consequence this could reduce the effectiveness of self governance to the codes. There is a perception within the industry that the Panels are not independent, but in our experience this is not the case. We believe that the Panels should be the decision maker and have no preference as to whether the Panel should be acting independently or representatively.

However, linked with the Role of Code Administrators Consultation, we would support a review of Panel compositions including an election process for certain industry representatives across all codes to ensure consistent and appropriate representation of relevant parties to that particular code.

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

See response to question 1 above.

3. What voting procedures should apply governing code decisions?

In order to fully benefit from the introduction of self governance we believe that, subject to a review of Panel compositions and the election process across the industry, the process should be as simple as possible with the Panels acting as decision maker by a simple majority.

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?

National Grid believes that appeals are equally important to all code participants and that all code participants should have right to appeal; including the ability to raise another modification proposal. The options considered for determining an appeal raises a number of issues in particular, a % constituency could be discriminatory against small participants and pre-notification may also not be possible prior to any industry development of the modification proposal.

We believe that Ofgem is the appropriate route for hearing and deciding an appeal as they set the licences to which the code objectives relate and this would also mirror existing self governance procedures. However, clear criteria needs to be determined to prevent numerous speculative appeals and a process to re-classify a modification proposal during the process from Path 3 to 2.

In practice, we believe that the number of appeals will be limited if the re-classification process operates effectively.

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

As stated above we believe an appeal right is equally important to all code participants and consumer and small participants should not receive an automatic right. Different modification proposals will have different and varying degrees of impact for each code participants and there is no justifiable reason to assume consumers and small participants will be more adversely affected than any other code participants.

Chapter 6

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

The three Path approach if implemented with the additional clarifications requested above may provide cost savings by preventing a piecemeal approach to change. However, it may not reduce the time taken to develop detailed industry modification proposals with all necessary analysis, as the issues will not be any less complex. In addition, industry resource are finite and the proposals may not reduce workload but will assist in targeting network operators, market participant and interested parties resources on the most important issues.

As stated previously, we believe the proposals are proportionate. However, Ofgem must to ensure that its independence is maintained and that the process does not create regulatory uncertainty. We do not consider that the current arrangements allow any particular party to exert undue influence and all interested parties have the ability to engage, as all reports include all comments received via the consultation processes. In particular, smaller participants are often actively engaged in the process where an issue has a direct impact, for example, during the development of CUSC CAP148 a significant proportion of the working group was made up of smaller participant representatives.

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

We disagree with the level of potential cost savings. As stated above an MPR would have reduced the piecemeal approach to electricity cashout and tagging but it would not have reduced the complexity of the issues or the significant divergence of views. In addition, the assessment fails to take into account the developing and changing views of both the industry and Ofgem over the relevant five year period.

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

We believe that the MPR process may ensure more consumer representatives are involved as it would provide a mechanism for such bodies to identify the priority areas and optimise deployment of resources in one process. As stated above, the MPR process may not save time in all cases and, therefore, may not ensure a more timely delivery of reform which aids competition.

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

The risks identified are appropriate and as stated above National Grid does not believe the Path 3 approach will be utilised to the levels anticipated within the consultation document. We also believe that a number of the risks can be mitigated by addressing the areas of concerns and clarification points within this response. Finally, we fully support the undertaking of a post implementation review.