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Code Governance Review: Major Policy Reviews and Self Governance

Dear Mark,

Please find below our response to the above consultation.

Our detailed answers to the questions are attached, however we have summarised our high level points;

- We have major concerns with the 'Major Policy Review Process' as outlined in the document. This could see Ofgem initiating a review, scoping it, leading it, setting out the modifications, writing the legal text and then pronouncing on the outcome. This does not seem like best practice to us and would be a retrograde step to the present governance arrangements.
- We support extending the self governance arrangements although we don't see the scale of advantage that Ofgem attach to this change.

Consultation Questions and Answers

2. Key issues and Objectives:

Question 1: Do you agree with our assessment of the deficiencies of the codes governance arrangements and do you agree that there is a case for reform? Are the proposed reforms a proportionate response to the problems with the status quo that we have identified?

We consider that in the main the current arrangements have worked well. Whilst there may be scope to improve them, there is no compelling case to discard the existing arrangements (which are widely understood) and replace them with a new regime that is untried and untested, particularly at a time when parties need to concentrate all their efforts on the real issues facing the energy industry (i.e. security of supply, climate change and affordability).

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 do not have sufficient detail on how the major Policy Review process is intended to work to provide detailed comments. However, given the complexity of the processes

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and materiality of the issues it would have been surprising if quick and straightforward solutions transpired as an outcome of a major policy review. It is, in our view, unlikely that the proposed changes to the governance arrangements will deliver a more satisfactory solution than the current arrangements (although they might superficially deliver quicker and shallower solutions which are then open to appeal to the competition commission or judicial review).

From time to time issues arise that merit wider discussion than the existing code governance arrangements allow. Ofgem has led such discussions on several occasions. These include reform of, transmission access, reform of the balancing arrangements, enduring exit reform and review of cash out prices. These initiatives have led to parties proposing changes to the codes and the existing arrangements have been adequate to deal with them.

Npower is concerned that Ofgem's proposals would greatly increase the risk to industry parties. Presently, we have an established and stable system of governance arrangements that provide parties and investors with certainty about the industry. We also have a system where parties can discuss changes and then seek the approval or other wise of Ofgem. This approach already allows parties to discuss key changes to the market arrangements whilst preserving necessary checks and balances to preserve confidence in the arrangements. Proposed changes are subject to scrutiny by parties and Ofgem. The arrangements preserve the important principle that, generally, only parties to the codes and agreements may raise modifications or amendments to change them.

There is no compelling argument to alter the current arrangements. In our opinion, they work and, they have underpinned the continued development of a successful market in retail and wholesale energy. On the other hand there are considerable risks associated with the proposed changes. Not least is the prospect of Ofgem initiating and managing a review, making recommendations on changes then proposing changes to the codes to deliver its recommendations and then making decisions on those changes. This is contrary to the principles of, accountability, balance and equity established at the time that NETA was implemented and that apply to the existing governance arrangements. Furthermore we believe that the proposals will compromise Ofgem's independent role in determining modification proposals.

If Ofgem was to adopt the major policy review approach it would distort the balance that exists between the interests of different parties and ultimately the customer. Rather than act in the interests of customers, we believe that the proposed arrangements could act against their interests. In particular we are concerned that the proposals will remove the objective impartial role and independent position of Ofgem in the industry in relation to determining industry change.

Furthermore, we have concerns about changes aimed to reduce the costs of the governance arrangements, which are very small compared to other costs in the industry. We believe the shortcomings in the analysis in some of the modifications could be addressed by more straightforward solutions (e.g. more use of independent consultants during the modification process) than an overhaul of the existing industry arrangements.

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

We support the extension of the existing self governance arrangements to take in all the codes and agreements. There is a strong argument for change to allow Ofgem to focus its attention and resources on proposed changes that have no impact on competition. Ofgem's analysis confirms that presently many changes to codes and agreements could take place without compromising competition.

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?

Ofgem state in paragraph 2.19; “However the modification process would be improved as Ofgem would make decisions only on modification proposals that are likely to have, amongst other things, impacts on competition and/or consumers”. We support this approach.

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 support the one size fits all approach in this case as there are examples of codes where we believe the process works well as it is. This should be done on a code by code basis and only where this is a clear rationale for change.

3. Filtering Criteria

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

Panels have developed expertise in analysing the scope of modifications and the application of the applicable objectives. Ofgem should, in the first place, rely on the Panels to decide the appropriate path for each change. In the event that Ofgem disagreed with a decision taken by a Panel it could set out its reasons to the panel which would then be considered by the panel.

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

The filtering criteria suggested within the consultation document would seem appropriate.

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

Ofgem should take note of such a modification and if relevant formally include its suggestions within the scope of the Policy Review. The modification should then be cancelled or withdrawn.

4. Proposed “Major Policy review” process

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

We do not agree that any such process as described within the document is necessary.

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

It is this aspect of the proposals that raises most concerns. We have referred to the prospect of Ofgem raising major policy issues, instructing the industry panels to make changes and then to confirm the changes. Ofgem already has powers to investigate issues of competition and has used them throughout the lifetime of liberalised markets in the gas and electricity supply industries.

We acknowledge that changes to Ofgem’s duties now require it to shift its focus to take more account of issues of sustainability, customer and security of supply. However, we question whether the proposed

approach is appropriate or desirable. We have seen several examples of where Ofgem has lead major reviews that have resulted in significant changes to the industry arrangements. Industry parties will look to Ofgem to take on a leadership role in such circumstances and would expect it to make recommendations for change.

On the other hand taking powers to require industry parties to make changes to the codes, or even making the changes directly is not appropriate. Ofgem already has powers to propose modifications to licences and could use these to require parties to make changes to the market arrangements. In our opinion, Ofgem intervening directly or indirectly in the code governance arrangements would be unnecessary and undesirable.

Of greater concern is that Ofgem proposes to remove the separation of responsibilities in the change process. Presently, only industry parties, and representatives of customers can propose changes to the codes and agreements. Under some existing governance arrangements parties can agree changes without recourse to Ofgem. In other cases Ofgem will decide on the merits of a proposal, taking into account all of it's and the code's objectives.

Given its role to make decisions on proposed changes it would unlikely that Ofgem would turn down change it proposed. Taking these powers would mean that Ofgem effectively neutered the industry change arrangements. If that would be the case parties in the industry would only have recourse to judicial courses of action, including references to the Competition Commission. In the past these have proved to be extremely costly to both Ofgem and appellant parties and these costs may well be passed on to customers.

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

Ofgem should produce a set of recommendations that industry parties then consider for implementation. If Ofgem then considered that the subsequent set of changes failed to meet its requirements it could encourage parties to propose further changes or use its existing powers to propose suitable modifications to licences.

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

We have expressed our concerns in the answer we have given in (2) above.

Appeal to the Competition Commission and Judicial Review will always remain an option to industry participants but this has proved costly and time consuming in the past which does put into question whether the powers that Ofgem are considering taking are proportionate to the issues they believe require addressing. Also, Ofgem have powers to prevent their decisions on code modifications being appealed to the Competition Commission in certain circumstances, which would be of greater concern if they are the effective progenitor of modifications.

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

No, past practice has shown that following a major change a number of further modifications may be required to fine tune the arrangements for example in the case of gas entry and exit reform.

5. Proposed “Self Governance” Process

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

This is another case where one size does not fit all and each code should be considered on its merits.

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

We do not feel this is necessary as the panels will have been through this process and those that feel this class of representation is required already have this in place.

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

We believe that the voting arrangements adopted by panels should reflect what the panel is trying to achieve and therefore these arrangements should be determined by the individual panels.

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?

The present appeals mechanism should be retained as it provides the right checks and balances. Experience has shown that appeals have only been raised where there have been genuine concerns.

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

No, the present arrangements are adequate.

6. Impact assessment

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

We are concerned as to how these reforms benefits will be measured. For example, how will cost effectiveness be compared to the current arrangements and how, under these proposals, is high quality analysis going to be guaranteed?

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

No, there are far too many assumptions to justify these cost savings, although we agree that if the new arrangements increase the speed and effectiveness (best case scenario) of modification changes then there is case to argue that costs could be reduced. However, some of the proposals could increase the time, cost and complexity of the change processes.

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

No, we do not believe that Ofgem has made the case for the scale of reform proposed.

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

We think the scale of the changes being presented; potentially pose a far larger risk than identified in the consultation document.

If you wish to discuss any aspect of our response, please do not hesitate to contact me.

Yours sincerely

Alan McAdam
Wholesale Economic Regulation Manager