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Dear Mr Feather

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

Welsh Power Group Limited is a dynamic independent power company. It is the owner and operator of Uskmouth Power, a 363MW coal fired power plant in South Wales. Welsh Power has a subsidiary Severn Power Limited who is developing an 850MW gas-fired power station on the brown-field site next to Uskmouth Power. We also own Haven Power a small supplier in the I&C electricity market.

Welsh Power believes that some improvements could be made to the change process, adding strategic thinking, transparency and coordination. However, we are opposed to Ofgem's proposal for Major Policy Reviews, which we believe would add to regulatory risk, work load and Competition Commission appeals, in which smaller users cannot participate. As we are only active in the power market our response is limited to the BSC and CUSC.

#### **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?

Welsh Power believes that Ofgem have identified as "deficiencies" some of the things that we would see as strengths, for example we value the ability to raise changes in response to other modification proposals, the fact that commercial interests diverge, but all views are heard, etc.. While we can agree that there are changes that could be made to improve the efficiency of the governance process, for example the way that the BSC modification process works, but generally we do not think that the problems are as obvious as Ofgem suggests.

**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?

While we can understand the benefits of strategic type reviews we believe that Ofgem can already carry out these reviews, as proved with the cash-out review, Supply Licence Review, DN sales, etc.. However, these review need to be clearer about what the purpose of the review is, the basis on which proposals will be judged and what outcome, in terms of deliverables, Ofgem then want. Taking cash-out as an example, Ofgem's review really did not point to specific changes that they wanted, so they should not now complain when they did not get the modifications to align with their undefined requirements. The final modification (P217) was actually raised in relation to a real problem that arose in terms of spiralling constraint costs.

Looking at the paths Ofgem outline, Welsh Power would have considerable concern about the idea of "legally binding conclusions" and how they fit with an appeals mechanism. To date changes put into licences have not been met (in gas) and on changes like TAR the high level principles unwound as the working groups found that the original concept (trading zones) could not work in practice. We suspect that the Competition Commission will also have concerns about how appeals to them could unpick the policy that Ofgem has made "legally binding", but it may be possible to address this with an appeal mechanism that comes more quickly after the conclusions of the review.

We would note that the TAR groups have met some 60 times to work up the TAR proposals. Welsh Power does not think that Ofgem will have the expertise to deal with details and therefore may only be able to conclude high level principles. What happens if attempts to transpose these principles into pragmatic business solutions serves to show the solution is actually unworkable? If as a party we raise a modification can it be hijacked into the Major Policy Review? These are serious issues that we can see no easy way to address. Both also suggest increased meetings, not decreased, would give less control for smaller players and possibly increased appeals.

Finally Welsh Power is concerned that Ofgem does not have the resources to carry out these reviews. It therefore seems likely that they will instead hire consultants who may also lack actual business experience. We believe that a similar outcome could be achieved by Ofgem attending and participating in more industry meetings. They can present papers, share concerns, ask for additional analysis to be done, etc.. Greater engagement by Ofgem would be likely to be effective in getting a broader view of some of the bigger policy issues. Ofgem should not be afraid to take a more active role in the current governance processes. Active engagement would not fetter their discretion in reaching decisions, but could reduce regulatory risk by creating a more collaborative development process.

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

As a smaller player, Welsh Power is happy with the concept of self-governance, but believe there are few changes that will actually be uncontested and can therefore follow this route. As ever, the devil is in the detail, but our key concern would be about having the same possibility of getting change via the self-governance route as our far larger competitors. We are particularly concerned that if there is voting on a size basis then the big 6 will get to design markets that work for them and niche developments will not be facilitated.

**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?

Welsh Power do not support the Major Policy Review process, but do believe that the other two routes are potential improvements. However, there are more practical changes that would also help, for example:

- Requiring the BSC to create workstreams so that the modifications that interact can be dealt with in a more coordinated and efficient manner.
- Getting more active engagement from Ofgem in the current change processes.

- Ofgem could bring proposed licence changes that accompany modifications to the same groups.
- Monopolies could be required to bring pricing papers with modifications so changes are considered in the round.
- Publication of Authority papers and detailed minutes so that participants can see which issues are being debated and get a feel for views.

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

For smaller players having similar rules throughout the energy markets is beneficial. It would therefore be advantageous to have all codes with similar governance as soon as possible.

### 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?

Welsh Power would like to see the Panels making the filter decision between self governed change and modification process with an Ofgem decision. However, that means that the Panel has to be clear that the views of the market support the change before sending it down the self governance route. Even if a change is set down that route parties need the right to appeal that to Ofgem.

For smaller players the key is to keep consultation to manageable level so that active participation is not a barrier to entry. However, where changes risk their own businesses they need the right to appeal to Ofgem, and ultimately the Competition Commission, in a timely and proportionate process.

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

Welsh Power's key concern with the Policy Review option is that the review may not relate to actual concerns raised by any party, but instead a desire to implement ideological change. For issues that potentially create significant change path 2 still allows for working groups to develop proposals in a manner in which Ofgem can take an active role.

Under Option A there is a risk that Ofgem may not be fully aware of their impacts without having the initial consultations that would occur under Option B, where the modification would be discussed by the Panel with industry input. There is no evidence to suggest that the industry cannot make reasonable decisions about how to classify modifications as appropriate for a self governance route. Were any one party to be concerned by the chosen route they could appeal to Ofgem, but we would suspect that to be infrequent.

The criteria used by the Panel for choosing the self-governance path should include:

- The modification is worked up enough for implementation, having used the working groups to gather industry input to design.
- There are no material objections to the self governance route by any parties, including customers.
- The modification has no knock on effects in terms of other codes, licences or material charges.
- The modification has no impact on other changes going through the Path 2 route.

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

Welsh Power believes that the idea of a moratorium on modifications is unacceptable as a review may be taking a long time when an urgent issue arises. Ofgem would also be sending the message that new

changes are unwelcomed when a party may have come up with a solution while not having been party to the review. While the ideas raised in the modification could be fed into the review, if a modification is solving an issue impacting the market it should be dealt with in a timely manner.

Were the Cash-out Review to have been ongoing when the constraints issues arose to have not allowed the industry to work on a pragmatic solution because of the review would have been a dereliction of duty. Also if a party has decided as a result of review work they have a change that could now move to an “assessment” type phase, with involvement from system providers, etc., a move towards faster implementation may be possible. Ofgem has a history of taking a long time to reach decisions, and to provide “legally binding” results could be far slower than the modification process.

Ofgem must also be careful that the codes are commercial contracts, that the industries rely on to operate their businesses. To take away the right to alter the contract would significantly increase the regulatory risk for parties. For example the TAR process should not rule out modifications to say help with current TEC trading if an opportunity arose between parties to trade, but that required a CUSC change.

#### **Chapter 4**

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

Welsh Power does not believe Ofgem have made a good case for requiring this process as defined. As noted above Ofgem can undertake such reviews using the current processes and by undertaking more active engagement with the industry. We believe that change could be more coordinated, but Ofgem must be careful not to be proposing changes that are not supported by the industry or its customers.

We therefore do not believe that Ofgem can have “legally binding” conclusions and still retain the right of a party to appeal to the Competition Commission. The rights of appeal are vital to offer a check to Ofgem’s regulatory powers, especially if they were to be undertaking to be the judge and jury on significant changes to the market. If an Ofgem review has worked up a solution that has support a party will raise the necessary modification to implement the changes. Ofgem has also used the TO/SO to implement changes in both the gas and power markets.

Welsh Power would therefore propose that Ofgem’s reviews should conclude with as much detail as can reasonably be achieved with the expertise available. For example if Ofgem described a change in great detail it would have to have undertake all the necessary impact assessments with systems, etc.. before reaching a conclusion. We are not convinced that business rules, IT development, etc. should sit with Ofgem as the current modifications process has a good track record on managing change development and implementation.

We are also concerned that the right to appeal to the Competition Commission must be kept and therefore Ofgem must be careful not prejudice outcomes and lead the market to developments unsupported by parties and customers. Any new arrangements must be compatible with the retention of the right to appeal, which we believe was put into the Energy Act 2004 to add a better balance of power to the regulatory regime.

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

As noted above the outcome should give as much detail as Ofgem can, but should not be binding if the technical assessment and implementation processes discover unforeseen problems. We would note that the use of sun-set clauses, etc has ended in them having to be unwound when change could not be believed as originally anticipated.

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

Option 1 would provide the best means to meet the objectives set out above.

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

Welsh Power would like to understand from the Competition Commission and associated legal experts how an appeal on policy rather than a Judicial Review of process can be achieved if Ofgem lead a review and the formation of subsequent policy. It is our understanding that the Competition Commission raised concerns over Ofgem's role in the modification process under UNC mod 116V and 116A. Checks and balances must be retained and Ofgem will have to reassure the market that their proposals do not remove or compromise existing rights of appeal.

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

No. It would be a risk to assume that in concluding a review that Ofgem have somehow foreseen all situations that may arise. It would also be a mistake to assume that the implementation of a modification would always have the expected consequence. When NETA was implemented one of the problems the governance process sought to address was the slow nature of change, so to remove the rights to make further changes would appear to be a retrospective step back towards the Pool.

## **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)?

Welsh Power does not believe a truly independent panel would have the necessary industry expertise. Asking industry representatives to act independently (as the BSC does) is not effective as the members views are always coloured by their own experiences and employer's interests.

Representative panels, however, have the problem that carving up the market by "stakeholder groupings" is always difficult as integrated players can fall into so many groups. Voting would therefore appear to be the most equitable, but then the voting rules become key. While we favour the second two options, the rules must be clear to protect and represents the interests of parties such as ourselves who do not have the resources to participate in the governance process in the same way as our larger competitors.

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

Ideally Panels should represent all parties, but it is difficult to see how customers or smaller participants could resource these seats. The role of the Panels is mainly administrative so those parties wishing to influence change must take a more active role in the modification meetings rather than the Panel. An obligation for the Panel to specifically consider the impacts on smaller players and customers may work better, also focussing the modifications group themselves on these parties.

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

Welsh Power prefers the super majority voting as it does keep the thresholds for consent higher, which we see as an advantage in a market with dominant players. However, we believe the weighting of votes by type of party needs to be considered so that smaller players can carry change where it allows, for example, development of niche product.

**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?

Assuming that the process for choosing which modifications go down the self-governance route are robust, there should be limited use of appeals. Appeals could also be further discouraged if a modification that changes materially in design during the modification process must go back to the Panel for re-consideration of the appropriateness of self-governance process.

As we believe that appeals will be infrequent we think Ofgem should allow all appeals, but set down a process and timetable for carrying out an appeal. The process should set out a timeline, when further consultation would be considered, what will be required from the appellant, etc..

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

Everyone should have equal rights of appeal.

## **Chapter 6**

Welsh Power does not feel that Ofgem has made a very robust case for change on the scale outlined. We are concerned that the workload for smaller players could increase with more meetings, need to vote on changes, more Ofgem documents from reviews, etc.. While we agree the process could be improved and better co-ordination would be beneficial, we do not feel Ofgem has given enough consideration to changing its role in the process to be a more active participant and improve collaboration on developments.

We disagree with Ofgem that smaller players have not been able to participate in TAR, but it has been hard work. To have more reviews similar to TAR operating alongside the mod process would be extremely difficult for smaller players. However, TAR has also benefitted from Ofgem attending and actively contributing at the meetings. Such participation, more regularly and by more senior members of staff, would we believe enhance the governance processes for everyone.

Welsh Power does not feel that Ofgem has fully captured the potential regulatory risk that Major Policy Reviews could create. Does Ofgem have a view on policy areas it currently considered may need such a review in the next year? This sort of steer may be of help in managing the risk. The risk is not just from unforeseen changes, but also if code changes were frozen when changes are needed. Ofgem's view is that the risk is from non-delivery of outcomes, but there is also a risk that the chosen solution will not work in practice, and Ofgem's resourcing of such reviews is likely to be expensive.

I hope that you find these comments helpful. If you have any questions or wish to discuss any of the issues raised in this letter please do not hesitate to contact me on 020 7659 6620 or Lisa Waters 020 8286 8677.

Yours sincerely



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