

Legal & Regulatory

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Dear Andrew

Re: Code Governance Review: Major Policy Reviews and Self Governance – Initial Proposals

We strongly support the principle of a Major Policy Review process and believe that subject to additional controls being in place to both manage Ofgem's application of the process and protect the rights of industry parties, customers will benefit from improved arrangements. Well functioning governance is a critical part of a stable regulatory framework, and without appropriate reform of these arrangements there is a risk that future developments in the UK energy market could be hampered.

As we set out in our letter of 27th February 2009, there are key strategic reforms to be delivered in the future which will be difficult to achieve under the current industry rules. For example, the necessary coordination to deliver major industry change like smart metering, sustainability and environmental solutions across numerous codes is likely to be problematic without reform. These changes are vital to the long term operation of the UK energy market and we agree that it would be both helpful and appropriate for Ofgem to facilitate developments. Our concern is that without reform being executed in a timely manner, the industry will struggle to deliver the products and level of service that our customers demand.

We are supportive of Ofgem taking a central "facilitation" role for major change, however this is a major departure from the current arrangements and whilst we recognise the important amendments made by Ofgem since our first consultation response, we do have some outstanding concerns.

Ofgem's proposals on allowing the industry to decide on issues which have low consumer or market impacts will allow change which is often technical and obscure in nature to progress quickly. These changes will aid the efficient and effective operation of industry codes, and any measure which improves the efficiency of the decision making process they are subject to is welcome.

Summary

1. We support the principle of a Major Policy Review, subject to the detail on how Ofgem's decision making will be transparent and open to challenge throughout the process.
2. We have a different interpretation on the rights of appeal afforded by The Electricity and Gas Appeals (Designation and Exclusion) Order (2005), and believe that more needs to be done to ensure that parties have appropriate opportunities to challenge any modifications Ofgem accepts following an MPR process.
3. Core requirements of any process include effective input by all stakeholders, in addition to transparency and robust rights of appeal. Parties' rights to contribute to an MPR process

before, during and afterwards should therefore be enshrined within the process framework. In particular, it will be important to ensure that the topics and prioritisation of MPRs are agreed by a cross section of the industry.

4. We are pleased that Ofgem are willing to provide the industry with more scope to decide on change with low consumer or market impacts. This would result in important modifications being progressed much more rapidly, as well as releasing Ofgem resource to concentrate on more strategic matters. From this perspective we encourage Ofgem to separate self governance proposals from the MPR process.
5. We support Ofgem's proposal that clear criteria are needed for the filtering process for change, and see this as key to ensuring change progresses quickly and at as little cost as possible, these criteria should be published and maintained.
6. We believe that Ofgem should do more to detail the controls that will be in place to manage the backstop and veto powers they plan to take, for example, in the case where they believe modifications are not drafted in a timely manner, or they have declined to permit a modification proposal to proceed.
7. We believe that decisions on changing the path any modification should follow should be open to a fair appeal, free from any conflict of interest.

More detailed comments on both Ofgem's proposals can be found in the attached Appendix. We are happy for this response to be published within Ofgem's library and website. Should you wish to discuss any of the points raised in this response, please do not hesitate to telephone me on 07789 570501.

Yours sincerely

David Watson
Regulatory Manager

APPENDIX ONE – DETAILED RESPONSE

- 1.1 Current industry and regulatory change processes have been largely successful at delivering incremental reform. We agree however they need to evolve to meet the levels of strategic change which the industry will see in the coming years. We agree with Ofgem's conclusion that a fragmented process can cause issues, and agree that the solution should be a process which allows large strategic policy decisions to be made in a co-ordinated fashion, with appropriate controls. In particular, this will be of great benefit when implementing related change across a number of codes.
- 1.2 We therefore support the proposed approach outlined in Ofgem's consultation document, subject to the need for robust controls, checks and balances to be in place

Determining the code modification pathway

- 2.1 If there are to be several different paths for managing industry change, it is critical that robust procedures are put in place in order to ensure the right path is chosen and that continuity is maintained wherever appropriate. Not only will this ensure that modifications are appropriately developed, but it will also make sure that the time and cost taken to progress change through the industry is no more than is absolutely required. This ensures that solutions are delivered in a timely and low cost way, with minimal strain on parties' resources.
- 2.2 We are therefore pleased that Ofgem agree with us that panels should have the ability to decide on the appropriate path modifications should take, and that Ofgem should have a right of override if they can demonstrate the wrong decision has been made when referenced with the agreed filtering criteria. This will allow panels to make a decision at the point of raising the modification, report that decision to Ofgem and then proceed immediately with the evaluation of that modification, reducing the amount of time it will take to progress change.
- 2.3 Furthermore, we agree with those respondents who said that parties should be able to appeal any decision by Ofgem to override the path chosen by panel. Whilst a general right of appeal exists on the qualitative decision made on the modification at hand, the decision made as to which path a modification should take has fundamental implications for the time, resource and cost it will take in order to progress a modification. We consider that by setting out the filtering criteria upon which such decisions are made will provide the appropriate basis for any appeal, with appellants having to demonstrate that an Ofgem decision was made contrary to the filtering criteria.
- 2.4 We agree there should be filtering criteria for panels to use in order to determine the correct path, and believe that publishing this in detail will provide market participants with the clarity and transparency they need in order to assess and challenge decisions made on the path modifications progress down. We think that these criteria need to be supplemented by Ofgem with guidance to panels on what should be considered a "significant impact" and what should be considered a "non trivial impact".
- 2.5 Notwithstanding this, we have some concerns at the proposed approach to handling modifications which are within the scope of the MPR. Whilst we understand Ofgem's desire to co-ordinate MPR change, we can foresee legitimate reasons for urgent change to be progressed in a particular area during an MPR process, and we are keen not to hamper such change in clearly important areas.
- 2.6 We suggest these two competing needs can be balanced by Ofgem setting out the precise scope of any MPR at the outset, and obligating parties to submit any change within that scope to them for a decision on whether they can proceed in isolation. This will enable Ofgem to retain the necessary control over the process, whilst still providing the industry with a route to progress important change during an MPR. Furthermore, we suggest that there is existing assessment criteria, for example the urgent modification criteria within the Uniform Network Code, that could be used for Ofgem's assessment in this area.

- 2.7 Whilst we are pleased that Ofgem has recognised the benefit in allowing parties to raise modifications immediately following an MPR process, we believe that their proposals in this area are too restrictive, even with the possibility of raising of new changes within a “time window” and may still lead to important innovation and development being hindered. Such change may well complement the wider strategic change implemented by an MPR, or even correct unforeseen negative impacts of an MPR related change, and it is therefore vital that these restrictions are removed, allowing parties to raise changes whenever appropriate.
- 2.8 Finally, we are pleased that Ofgem agree with us that there should be a mechanism to move modifications between paths. In the context of modifications moving between paths 2 and 3 (and vice versa), we believe this right should not be limited to Ofgem but should also extend to panels. This will expedite any decision, and avoid delay to important change being progressed as Ofgem resource is taken up assessing the merits of changing the path for a modification.

Proposed “Major Policy Review” process

- 3.1 We strongly support the principle of a Major Policy Review (MPR) process, and, with suitable amendments, believe that it would offer an effective solution to the difficulties of co-ordinating industry change. We believe that proposals in this area are essential for ensuring that important strategic changes in the UK energy market are not hampered. We have some concern over the lack of detail in certain key areas and would like Ofgem to take this opportunity to address this.
- 3.2 Specifically, we would like greater clarity on the process by which the need for an MPR is determined. We agree there are a number of useful routes to be explored and we suggest a combination would give the best outcome. However, we would suggest adjusting the proposals under 4.11 as follows:
- a) DECC could require an MPR to be initiated as a response to legislative change, or advise on particular or relative priorities, for example those covered by social and environmental guidance.
 - b) Ofgem could initiate an MPR in response to a strategic policy decision by DECC/Government.
 - c) Ofgem could initiate an MPR in response to requests by stakeholders.
 - d) Ofgem could seek stakeholder support for an MPR on an issue it wishes to pursue.
- 3.3 In this sense, “stakeholders” should be given a wide interpretation and taken to include government agencies, consumers and their representatives, as well as regulated networks and other industry participants. This will assist with generating support for the process, support that once achieved allows Ofgem to assume the role as facilitator for change.
- 3.4 If a proposed MPR lacks stakeholder support, we believe that this should reasonably raise the question of why such high priority change is required. We believe that this approach may reduce conflicts later in the process.
- 3.5 A simple and flexible right of appeal on a modification resulting from an MPR provides the necessary control to prevent Ofgem being seen to be the “judge, jury and executioner” on any change. We are therefore pleased to see that Ofgem is keen to enshrine this right of appeal in any resulting process. We do have a different interpretation of the appeal rights currently contained within The Electricity and Gas Appeals (Designation and Exclusion) Order 2005 however, and believe that under section 4 of the Order any appeal to the Competition Commission can only proceed if Ofgem reject any a modification. It is important an Ofgem decision to accept a modification resulting from an MPR is subject to the right of appeal, and we therefore ask that Ofgem take steps now to make clear how this could happen.
- 3.6 Ofgem’s assurances that MPR conclusions will be high level, allowing market participants the flexibility on how best to implement them, are also welcome. Each code differs to a large extent in both form and function, and we are pleased that the centralised, Ofgem led, approach to policy implementation will be avoided providing that Ofgem is satisfied with the industry approach and progress. We believe this solution will expedite delivery of MPR

conclusions, and ensure that the end result better meets the intended outcome. We would however welcome assurances that if a party is obligated by Ofgem to raise a modification following an MPR, that their own subsequent right of appeal to the Competition Commission would not be fettered.

- 3.7 We have some concern that the backstop powers Ofgem plan to take in the cases where they consider modifications are not drafted in a timely manner may present the Authority with a conflict of interest when the resulting modification comes back to them for a decision. Whilst we appreciate that allowing parties to draft a modification without time limits presents a risk, we believe this can be overcome by referring the drafting to the appropriate panel after a reasonable period of time. We also believe that Ofgem should take steps now to set out the controls which will exist to ensure any backstop powers are used appropriately and publish in advance the detailed criteria it will use to inform its assessment. For example, we believe that any decision should be supported with clear and transparent rationale, and only be taken following a dialogue with the licensee or licensees responsible for drafting to assess possible reasons for the delay.
- 3.8 We welcome Ofgem's proposal that market participants can request an MPR at any stage, but would like to understand how such decisions on these requests will be made. Clearly any decision needs to be taken in a structured and transparent way if parties are to have faith that their request has been treated seriously. We therefore ask that Ofgem set out the controls associated with any decision before these proposals are progressed.
- 3.9 Whilst we agree the MPR process should be flexible in order to take account of the variety of topics which could be potentially handled, we believe that some details can, and should, be set out now. For example, we believe that minimum consultation periods can be agreed for before, during and after an MPR process. We also believe that Ofgem can go further in setting out the degree to which the rationale and decision making processes within the MPR are shared, and provide detail on where market participants rights of representation will be enshrined.
- 3.10 Finally, the outcome from an MPR process needs to be sufficiently flexible in order to adapt and change as new information and ideas are presented. It is therefore important that Ofgem retain the right to vary MPR decisions if they receive new information, and it is equally important that the proposed restriction on parties raising modifications on the same subject is removed.
- 3.11 This restriction on the change process appears to us to risk unnecessary delay and cause a potential hindrance to the necessary development of associated change. We consider that as Ofgem already possess the ultimate decision on these modifications, the risks of allowing them to be raised are minor when compared with the potential benefits increased debate will bring.
- 3.12 The proposals on varying MPR decisions following receipt of new information needs careful consideration, for example, we believe the provisions need to be much clearer and the criteria for change published. At the extreme, if Ofgem had completed an MPR process and issued directions to the relevant licensee to raise the appropriate modifications, the resulting modification process might be in the final stages and the report with Ofgem at the point of change.
- 3.13 We would like Ofgem to take this opportunity to set out the process by which, in such circumstances, stakeholders would be advised of the new information, consulted on their views, and given the opportunity to contribute to the revised solution. The lack of certainty inherent in this process could increase regulatory risk significantly at a time when investor confidence in the regime needs to be supported. It would therefore be useful to understand in advance the materiality tests, both qualitative and quantitative, Ofgem would apply.
- 3.14 Finally, we anticipate that Ofgem intends proposing changes to the generator, supplier and shipper licences to obligate parties to bring forward modifications as a result of an MPR process. We would like to understand as a matter of some importance the content of these changes, and would appreciate sight of draft text to consider as soon as possible.

Self-governance

- 4.1 We strongly support Ofgem's intention to increase the degree to which the industry can self govern, and believe that subject to robust and guaranteed rights of appeal, this will expedite the implementation of important change required for the effective operation of the codes themselves.
- 4.2 We are encouraged by the importance that Ofgem attaches to these proposals and support the view that this will benefit consumers by improving efficiency and economy. In these circumstances, we do not understand why increased self governance has to be tied to the proposed MPR process and ask Ofgem to decouple these separate proposals.
- 4.3 In addition, we would like more clarity on why Ofgem considers consumer representatives should have potentially casting votes on path 3 modifications. By definition, such modifications will have trivial effects on consumers and if this position changes, Ofgem has the power to move the proposals to path 2. It seems likely that the majority of path 3 proposals would be detailed and technical in nature, of limited interest to consumers.
- 4.4 We believe the industry can decide on the best process to manage such modifications, and have set out our preferred model within our response to the Ofgem consultation "*Code Governance review – role of code administrators and small participant/consumer initiatives – Initial Proposals*". Notwithstanding this, we agree with Ofgem that wherever possible self-governance processes should be aligned, and that there should be a general right of appeal to Ofgem on modification decisions, as currently exists in a codes such as the Master Registration Agreement (MRA) and Supply Point Administration Agreement. This is vital if we are to provide effective checks and balances on the powers of panels.
- 4.5 We do not however agree that a forum should be established to provide an initial appeals body on any dispute. Our experience in codes which have used such a body in the past to hear appeals is that the forum would be made up of representatives from the very parties represented on a panel. As such a forum simply reaffirms the view of the panel, making it an unnecessary and costly delay only serving to postpone the eventual referral to Ofgem. We note that it is for these very reasons that the MRA Forum no longer acts as the first point of appeal in the MRA, and SPAA is not considering the use of a Forum for its forthcoming breach procedure.
- 4.6 Finally, we also believe that the proposals to increase consumer and Ofgem representation on panels, and therefore forums, will reduce the opportunity for industry parties to appeal successfully against Ofgem initiated change. If such representation is mandated therefore, we would like to see safeguards introduced to ensure that safeguards are put in place to ensure any appeal is heard fairly, and is not subject to conflicts of interest.