National Grid House
Warwick Technology Park
Gallows Hill, Warwick
CV34 6DA

Andy MacFaul
Head of Better Regulation
Ofgem
9 Millbank
London
SW1P 3GE

Alison Kay
CUSC Amendments Panel Chair

alison.kay@uk.ngrid.com
Direct tel +44 (0)1926 653090
Direct fax +44 (0)1926 656605

www.nationalgrid.com

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Dear Andy

Code Governance Review Consultation on Major Policy Reviews and Self-Governance

I am writing to you as the CUSC Amendments Panel Chair on behalf of the CUSC Amendments Panel. Thank you for the opportunity to respond to the above consultation. We would also like to thank your colleague Mark Feather for taking the time to attend the August 2009 CUSC Amendments Panel meeting to outline the proposals that he and his team developed to us.

To begin with the Panel has some general observations regarding the proposed approach. Answers to the specific questions asked in the consultation document are provided in Annex 1.

A minority of Panel Members wish to be assured by the Authority that it is legally permitted to introduce its proposed approach. In particular, is the Authority able to act as the originator and approver of amendments associated with Major Policy Review items?[1]

The reason why some Panel Members are concerned about this is because if, subsequently, it turns out not to be the case then it would call into question the legality of all changes made (under the 'new' regime) to that date. Such a scenario could be extremely disruptive to the ongoing operation of the CUSC at that time if these 'invalidated' changes are required to be 'backed-out' of the CUSC.

The Panel appreciated the comments made by your colleague Mark Feather at its August meeting that the Authority has taken legal advice on this matter and the Authority is satisfied that its proposals are permissible. This does not appear to have been detailed in the consultation document itself. Given the importance of this matter (and the lack of any commercially confidential aspects surrounding it), a minority of the Panel believes that, in the interest of openness and transparency, it would be helpful to all concerned if this legal advice could be published by the Authority at the earliest opportunity.

In terms of the wider acceptability of what is being proposed, the Panel is mindful that, up to now, matters of policy (such as strategic market issues) have been clearly reserved for Government consideration (and also to Parliament) to both instigate any review of policy and to then determine what the policy should be.

[1] This issue, as discussed at the July 2008 CUSC Panel meeting, centred on the history of the industry Codes (and especially the electricity codes) in terms of them arising from specific primary legislation at NETA and BETTA, where those Codes (including the proposed Code amendment/change processes) were available to Members of both Houses etc., is it permissible for the Authority to take the proposed powers (to make Code changes itself) without primary legislation? A secondary issue, if the Authority can raise Code changes, is it also permissible, under the convention of 'natural justice', for the Authority to also sit in judgement on their own proposed Code changes?

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At the same time the role of the independent regulator (in the form of the Authority) has been limited to that of implementing policy and ensuring industry code changes are consistent with that policy.

Where substantive change of policy requires commensurate significant changes to industry codes; such as with the introduction of NETA, BETTA and the Offshore Regime; then Government (in close co-operation with the Authority) and Parliament have acted accordingly.

As noted in the consultation document[2] the Authority's "role is largely restricted to a decision-making body at the end of the modification process". The Panel is mindful that this restriction, placed upon the independent regulator, has arisen not by 'default' or 'accident', but rather as a result of a policy approach taken by various Governments, which has been endorsed by Parliament. In light of the above, the Panel believes it is important, if the MPR reforms are to be implemented, that both Government and Parliament are given the opportunity to agree with these proposals from the Authority.

Notwithstanding this, the majority of the Panel believes, on reflection, that the proposals related to 'Major Policy Reviews' are disproportionate. Rather, the majority of the Panel believes that the role of the Authority should be enhanced to include active facilitating of the debate of the key issues. In this way if the area of concern has merit commercially to even one CUSC Party then they will have the incentive to instigate that change, by raising an Amendment Proposal.

An example of where the Authority's facilitating of a debate on a key issue has been very productive was in the area of the cross industry code discussions on the credit cover arrangements, which resulted in CAPs 89 / 90 /91 being raised.

Equally, if an area of concern is of interest to consumers then Consumer Focus (as the body charged by Government and Parliament to represent consumers on the CUSC Amendments Panel) should be able to instigate that change.

Whilst in the past there may have been impediments to smaller parties and Consumer Focus raising such change proposals the Panel believes that the proposed changes, as outlined in the "Role of Administrators and Small Participants / Consumer Initiatives" consultation, should help to address these impediments.

To conclude, the majority of the Panel believes, now that they have had an opportunity to see the details of the proposed changes, that the MPR reforms are not suitable for taking forward.

However, the majority of the Panel does believe that the self-governance changes should be put into effect along the lines outlined in the consultation document. Furthermore, these changes could be brought into effect without implementing the MPR reforms (the majority of the Panel believing that they are not 'linked' as a package).

In addition, the majority of the Panel believes that the role of the Authority should, if necessary, be enhanced to ensure, as with the credit cover arrangements, that it is able to facilitate debate on key issues.

Finally, a minority of the Panel believes it would be helpful to all concerned, for the matters associated with legality of the MPR proposals along with the support of both Government and Parliamentary for these changes to be clarified at the earliest opportunity.

If you wish to discuss further please do not hesitate to contact me or Alex Thomason on 01926 656379 or alex.thomason@uk.ngrid.com.

Yours sincerely

Alison Kay

[2] 2.18 pg 8

ANNEX 1: Response to the specific questions raised in the consultation document

Chapter 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?

As detailed in the general comments above, the majority of the Panel does not agree that there is a case for the Major Policy Review reforms or that the proposed MPR reforms are a proportionate response to the problems with the status quo. However, the Panel is supportive of a more enhanced role for the Authority to include the active facilitation of the debate on key issues.

Question 2: Would the MPR process enable key strategic issues to be progressed more effectively and efficiently with consequent consumer benefits?

Given the recent example of the changes associated with the introduction of the Offshore Regime[3] the majority of the Panel find it difficult to identify issues that are not policy related (and thus to be determined, and implemented, by Government and Parliament) which industry (or Consumer Focus) could not seek to introduce.

Furthermore, given that the process cost of any change introduced by Government and Parliament falls, predominately, upon taxpayers (rather than consumers) it is difficult to agree that the adoption, by the Authority, of this role could be achieved in a way that benefits consumers.

Question 3: Would a self-governance route be suitable for a significant proportion of modification proposals?

Yes. The Panel wholeheartedly supports the speedy introduction, in principle, of the self-governance route at the earliest practical opportunity. However, some aspects of the self-governance reforms could be enhanced.

In addition the majority of the Panel has some doubts that, in practice, a significant proportion of Amendment Proposals would proceed along the self-governance route.

Finally, the majority of the Panel does not believe that the self-governance reforms should be regarded solely as part of a 'package' with the MPR reforms. Rather they can be introduced independently of the MPR reforms.

Question 4: If both the MPR and self-governance routes were implemented, is there a case for retaining an improved status quo path?

For the avoidance of doubt, the majority of the Panel support the implementation of the self-governance reforms but does not support the MPR reforms. Given this, improving the status quo path (alongside the self-governance reforms) has merit.

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

The Panel believes it should limit its comments to the CUSC only.

Chapter 3: Determining the code modification pathway

Question 1: Do you agree that, once a modification has been raised, the filtering decision should be taken by the relevant panel, subject to an Ofgem veto that could be deployed at any point before a final decision on the proposal has been made?

[3] via the Energy Act 2008

The majority of the Panel does not support the MPR reforms.

Notwithstanding this, the majority of the Panel consider that if the changes were to proceed there may be a significant increase in the regulatory risk of operating in the GB energy market place. This could arise because of the uncertainty that a change might be 'pulled' from one Path to another Path after, perhaps, many months of industry effort.

In light of the fact that the Authority can 'reject' an Amendment Proposal at the end of the process, the majority of the Panel believes it would be fair that the right of the Authority to veto the filtering (between Paths) is exercised only at the start of the process. In this way the uncertainty, for stakeholders, may be limited in a proportionate way.

Question 2: Do you agree with the proposed criteria that should be applied to assessing whether a modification falls into Path 1 or Path 2? Is further guidance necessary?

The majority of the Panel does not support the MPR reforms. Therefore, the need for Path 1 does not arise.

With respect to the filtering criteria for Path 2[4] the Panel believes that these seem to be, in principle, sensible criteria to apply. However, the uniform application of those criteria in practice will be critical, as well as ensuring that no CUSC Party is dis-enfranchised in anyway.

Question 3: Do you agree with our proposals for redirecting modification proposals between Paths 3 and 2?

The majority of the Panel broadly supports the Authority's proposals for redirecting between Paths 3 and 2. However, the Panel also believes that this redirection should only be exercised, by the Authority, once per Amendment Proposal.

In other words an Amendment Proposal should not, over time, 'flip' back and forth between Paths 2 and 3. Once the Authority has exercised its power to redirect (from one Path to another) then industry should proceed, with absolute certainty, to produce the necessary documentation etc., in accordance with that Path's change process arrangements so that a timely decision can be made as to the suitability of the change (according to the CUSC applicable objectives) under the (Authority) designated Path.

Question 4: Should code parties be able to make requests to Ofgem at any time that they can raise an urgent modification proposal to existing arrangements that are the subject of an MPR? Do you agree that there should be a moratorium for non-urgent modifications to existing arrangements that are the subject of an MPR?

The majority of the Panel believes CUSC Parties should be able to raise an 'urgent' Amendment Proposal at any time (as long as it conforms with the urgency criteria laid out by the Authority).

In addition to this the majority of the Panel believes that CUSC Parties should be able to raise a 'normal'; e.g. non urgent; Amendment Proposal at any time. In other words there should not be a moratorium placed, by the Authority, on the raising of any Amendment Proposals.

In this regard the majority of the Panel is mindful that the final decision to grant 'urgency' (to an Amendment Proposal) rests with the Authority. Thus whilst a CUSC Party, and perhaps the Panel, might believe in urgency, if the Authority decides otherwise, according to the consultation document[5], "the modification proposal would not proceed to consultation or decision".

This is an important power that, under the proposed MPR reforms, would rest with the Authority.

[4] as listed under 3.26 on pg 18
[5] 3.39 pg 20

On a related point the majority of the Panel believes that the criteria by which the Authority will determine what a 'sufficiently developed'[6] alternative Amendment Proposal is, should be published so that CUSC Parties are aware, as now with the CUSC, of the minimum detail that they have to provide for an alternative Amendment Proposal to proceed further. This is because the exercising of this power, by the Authority, could prevent a "modification proposal being raised and sent to consultation with industry participants."[7]

Chapter 4: Major Policy Reviews

Question 1: Do you agree that Ofgem should retain the flexibility to vary the MPR process according to the complexity of the issues involved?

Whilst not accepting the need for the MPR reforms, the majority of the Panel believes that, if they proceed, it would be helpful to CUSC Parties if the Authority published clear guidance on the circumstances under which it would vary the MPR process. This could also state what criteria it would apply (addressing, for example, what judgement would apply in determining 'the complexity of the issues involved') in these circumstances.

For the avoidance of doubt, if the MPR process is to be efficient and effective and clearly understood by all stakeholders, it would be useful if the Authority published the process (and timescales) it expects to apply for the 'least' complex and 'most' complex issues involved.

Question 2: What are your views on the options for determining the outcome of an MPR?

The majority of the Panel believes that the matters covered by the MPR reforms are not required.

However, if the Authority were to proceed with these MPR reforms then, in the view of the majority of the Panel, it may be necessary to establish a whole new, arms length (with appropriate 'Chinese walls') department within Ofgem that was entirely separate to the 'decision making' functions of Ofgem. This separate department could then articulate the arguments for the change and actively participate in Working Group meetings etc., as any other proposers of Amendment Proposals do.

It would clearly be inappropriate for the same parts of Ofgem that recommend to the Authority (or if delegated powers have been provided by the Authority, decide) if a CUSC Amendment Proposal should be implemented or rejected, also raised either directly[8][9], or indirectly[10], the Amendment Proposal (or an alternative) before the Authority for decision.

This is brought into sharper focus if the Authority has exercised its power with respect to (a) an alternative Amendment Proposal (is it 'sufficiently developed'[11]?) or (b) 'urgency' in such a way as it prevents any 'counter' Amendment Proposal(s), to the Authority's 'original' Amendment Proposal, being raised and considered by:-

i) CUSC Parties;
ii) the Panel;
iii) the Authority; and (potentially)
iv) the Competition Commission.

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[6] 2.34 pg 11 "we propose that Ofgem should have the ability to prevent insufficiently developed alternative proposals being raised"
[7] 2.5 pg 6
[8] 2.33 pg 11 "We also propose that Ofgem has the power to draft appropriate modifications in the event that the relevant licensee(s) fails to develop proposals that are consistent with the direction provided by Ofgem."
[9] 4.27 pg 26 "We also propose that Ofgem should have a "backstop" power to draft code modifications in the event that the original modification is not being progressed within the appropriate timescales or does not reflect Ofgem's policy conclusions."
[10] 4.26 pg 26 "…Ofgem setting down the principles that should inform any code modification proposal and perhaps outlining the code modification proposal itself. In practical terms, we envisage that Ofgem would assess on a case-by-case basis whether to set out high level or detailed principles only. In some cases it may be appropriate to include an outline code modification."
[11] 2.34 pg 11 "we propose that Ofgem should have the ability to prevent insufficiently developed alternative proposals being raised"

Question 3: Do you support our proposal that the industry should be given the responsibility of drafting appropriate MPR-related code modifications, with Ofgem having a power to draft them only if the industry fails to do so within as specified time period?

As noted in the general comments, the majority of the Panel believes that there is sufficient opportunity within the existing arrangements for either an affected CUSC Party, or Consumer Focus, to raise any Amendment Proposal without the need for the MPR reforms (as outlined in the consultation document).

For larger matters, such as transmission access reform, if there is a failure of these arrangements then the approach so recently determined, by Government and Parliament, should apply. The majority of the Panel believes that an appropriate change to the Authority's role could be to ensure it facilitates debates on wider matters; such as it did with the cross industry code discussions on the credit cover arrangements, which gave rise to CAPs 89 / 90 / 91 in the CUSC and other changes in the BSC.

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

The majority of the Panel has reservations as to the impact that the MPR reforms could have on, for example, CUSC Parties' ability to effectively appeal decisions to the Competition Commission. This is not just limited to the situation where the CUSC Party (as a licence holder) has been obliged to raise, and facilitate consultation on, the Amendment Proposal[12].

In establishing the appeal route to the Competition Commission, in 2005 Government and Parliament were mindful that the Authority's "role is largely restricted to a decision-making body at the end of the modification process"[13].

However, under the MPR reforms the Authority could be appearing before the Commission to 'defend' its decision not on an Amendment Proposal written/raised by a CUSC Party, but written/raised by Ofgem on behalf of the Authority itself. This appears, in the view of the majority of the Panel to run directly counter to circumstances under which the Competition Commission appeal route for industry code changes was established. It might also run counter to the notion of 'natural justice'.

In addition, as noted under Question 2 above, the Authority, in exercising its power with respect to alternative or 'urgent' Amendment Proposal(s) could have prevented any 'counter' Amendment Proposal(s), to the Authority's 'original' Amendment Proposal, being raised and considered by the Competition Commission.

Question 5: Do you support our proposal for a time-window in which subsequent code modifications could be proposed after the completion of an MPR?

We have taken Questions 5 and 6 together.

Question 6: Do you agree that Ofgem should be able to revise its MPR conclusions in the light of subsequent new information?

The majority of the Panel believes it would be inequitable if only the Authority can raise subsequent Amendment Proposals 'in the light of new information' whilst CUSC Parties cannot. Non discriminatory treatment of <u>all</u> is a central tenet of how the CUSC operates. The majority of the Panel does not, therefore, agree with this proposed change.

[12] 4.34 pg 27 "We consider that the relevant licence holder should have an obligation to raise and facilitate consultation on modifications that give practical effect to any MPR-related directions issued by the Authority."
[13] 2.18 pg 8

Chapter 5: Self-governance

Question 1: Do you agree that the industry should draw up proposals for panel and voting arrangements and submit them as part of a self-governance package to Ofgem for approval?

Yes.

Question 2: Do you agree with our proposals for redirecting modifications from Path 3 to Path 2?

Yes. As noted in our response to Question 3 in Chapter 3 above, the majority of the Panel broadly supports the Authority's proposals for redirecting between Paths 3 and 2. However, the Panel also believes that this redirection should only be exercised, by the Authority, once per Amendment Proposal.

Question 3: Do you agree that there should be general appeal rights equally applicable to all code participants? Do you agree with the proposed grounds for appeal?

Yes.

Question 4: Do you agree that Ofgem should hear appeals of self-governance modification decisions? Do you support the proposals in respect of interim forums, time limits and frivolous or vexatious appeals?

Yes. The majority of the Panel broadly supports the proposals with respect to the hearing of appeals. However, in terms of an industry code 'forum' being established to hear each specific appeal then, as the Panel outlined at its August meeting to your colleague Mark Feather, we believe, on reflection, that a more pragmatic and flexible approach could be for such a forum to be held under the auspices of the Authority itself rather than the industry code (such as the CUSC) in question.

In other words if an appeal were to be raised, by a CUSC Party to an Amendment Proposal taken through the self governance route, then this appeal would be held at a time / location set by Ofgem and chaired by Ofgem to which all CUSC Parties would be able to present their views / arguments for and against the matter being appealed. The conclusion of this forum 'phase' would be a decision, by the Authority, on the merits of the Appeal.

In terms of 'frivolous' and 'vexatious' appeals the Panel notes that it could be helpful to CUSC Parties if the Authority provided guidance on this, in due course, to avoid market participants being disappointed if their appeal were to be subsequently rejected on these grounds.

Appendix 2: Impact assessment

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

The majority of the Panel believes that the route for major policy reform, is via the involvement of the policy determining bodies, namely the Government and Parliament. The role of the Authority should be enhanced to ensure, as with, for example, the cross industry discussions on the credit cover arrangements, it facilitates debate on the matters of wider interest.

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

The majority of the Panel believes it is difficult to be certain that the suggested potential cost savings, from the reform, will, in reality, materialise. For example, it appears much of the cost of the proposed MPR reform could fall on consumers; whilst not all the existing costs do (such as the costs associated with Government and Parliament, which fall upon taxpayers).

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

The majority of the Panel believes it is hard to quantify the potential benefits or impacts that could arise from these MPR reforms.

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

As noted above in the general comments, the majority of the Panel believes that the risks of these proposals not receiving the appropriate support from both Government and Parliament has not been taken into account in the impact assessment.

In addition, whilst the Panel has alerted the Authority previously to a potential consequence if the legality of these proposals were successfully challenged in Court, the risks etc., surrounding the legality of the proposals appears not to have (a) been identified or (b) been addressed in the assessment.