



Andrew MacFaul
Head of Better Regulation
Ofgem
9 Millbank
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18th September 2009

Dear Andrew,

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

Drax Power Limited (“Drax”) is the operating subsidiary of Drax Group plc and the owner and operator of Drax Power Station in North Yorkshire. In March 2009, Drax acquired a small electricity supply business, Haven Power Limited (“Haven”); Haven supplies some 20,000 small and medium sized business customers and provides an alternative route to market for some of Drax’s power output.

Drax welcomes Ofgem’s latest consultation regarding Major Policy Reviews (MPRs) and Self-Governance. A full response to the questions raised in the consultation can be found in Appendix 1; however, Drax would like to put forward the following high-level views:

- Drax believes it is important to ensure that the regulator is not placed in a position where it is unable to make independent decisions, resulting in it being increasingly left open to legal challenge; this would not be conducive to an efficient change process, nor would it be good value for consumers;
- Drax believes that a more proportionate proposal would be to develop a process to *facilitate industry discussion*, which would allow parties to the relevant industry code(s) to make informed judgements on policy / code defects and how best to raise modifications to address them;
- The industry codes, particularly the BSC and CUSC, aim to have a code modification process that attempts to find the most efficient outcome for the industry as a whole, with the appropriate checks and balances in place to ensure that no single user is subject to discrimination;
- It is welcome that Ofgem has proposed to ensure that consumer representatives have greater involvement in the code modification process as a result of the wider Code Governance Review proposals, ensuring that the interests of consumers can be further protected via the raising of modifications;
- As a result of ensuring greater consumer representation across the codes, if it is in the interests of consumers or the relevant code objectives to raise a modification, then an industry party, code administrator or consumer representative would be in a position to make that judgement and raise a modification upon the conclusion of facilitated industry discussion;
- Given the above, it does not seem proportionate for Ofgem to hold a power to raise modifications when *all* potentially affected parties are capable of raising modifications and making representations; for this reason, Drax does not support “legally binding” conclusions or obligations on code administrators / industry parties to raise modifications as an outcome of an MPR-style process;

- Drax does support the proposal to introduce self-governance for modifications that do not have a significant impact on industry parties and consumers, provided that the relevant checks and balances are in place, including a Competition Commission appeal process;
- Drax does not believe that a “significant” proportion of BSC and CUSC modifications would be suitable for the self-governance route, due to the commercial nature of the codes in question;
- We believe that it would be a sensible approach to decouple and “fast-track” the self-governance proposals, in order to realise the efficiency benefits as soon as practicable.

We look forward to viewing both Ofgem’s and industry participants’ responses to this consultation. In the meantime, if you would like to discuss any of the views expressed in this response, please feel free to contact me.

Yours sincerely,

By email

Stuart Cotten

Regulation
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Appendix 1: Drax Response to Consultation Questions

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 stated in our previous response, Drax agrees that the modifications process in a number of codes may appear piecemeal, in terms of proposals to rectify a given defect being suggested at different points in time during the modification process. However, we still believe that the industry codes are structured in a way that allows *any* signatory to raise a modification regarding *any* identified defect as part of an *evolutionary* process.

There are occasions when the solution with the most efficient outcome for a particular defect may only be identified after the original modification has undergone substantial development and analysis. The ability for parties to identify alternative solutions and raise new modifications at *any* time enables the most efficient solution to prevail, even if it was not identified until later in the process.

Furthermore, Drax is still of the opinion that the current process does not require consensus in order to progress reform via code modifications; however, if such code modifications or general principles surrounding a given proposal for reform are opposed by a significant proportion of the industry, such opposition should be noted. If implemented without the correct checks and balances, MPRs have the potential to force a particular approach to reform, with the regulator being able to block further (potentially more efficient) proposals without due consideration.

On this basis, Drax does not believe that the current proposals are a proportionate response. A more proportionate proposal would be to develop a process to facilitate industry discussion, which would allow parties to the relevant industry code(s) to make informed judgements on policy / code defects and how best to raise modifications to address them.

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

As mentioned in answer to Question 1, Drax believes that a process to facilitate industry discussion and allow parties to make informed judgements on how best to raise modifications may be a more proportionate response.

Given that the current proposals do not detail a structured review process (the document states the regulator wishes to retain a high level of flexibility on how to structure the process for a given subject, including the ability to change its direction and conclusions), it is difficult to determine whether key strategic issues would be progressed “more effectively and efficiently”.

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

Provided that the relevant checks and balances are in place as part of the self-governance process (such as a Competition Commission appeal process) and that there is sufficient ability for a modification to be escalated into Path 2 (should the modification evolve into a proposal that potentially causes a material effect on competition or consumers), then a self-governance route would appear plausible. It should be noted that a minor change for one company may be a material change for another; the process must be well defined and involve the views of the regulator, code administrators and industry parties.

It would seem sensible to decouple and “fast-track” the self-governance proposals in order to realise the efficiency benefits as soon as practicable. However, it should be noted when assessing the benefits of self-governance that, due to the commercial nature of the codes in question, it would appear unlikely that a “*significant*” proportion of BSC and CUSC modifications would be suitable for the self-governance route.

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

Drax continues to believe that there is most definitely a case for maintaining a “status quo” path; in fact, we would expect this to remain the most utilized path for BSC and CUSC modifications. Placing a large proportion of modifications through an MPR-style process, rather than a status quo path, would make the modification process less efficient.

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

Drax only currently engages (in any extensive way) with the BSC and CUSC processes; therefore, we may not be best placed to comment on the other industry codes. However, we appreciate that each of the codes covers a very different area of the industry, for example: network connections, trading, metering, settlement systems, etc. Therefore, one size may not fit all.

If such reforms were to be implemented across a number of codes, it may be prudent for the arrangements to be tested on a single code first, rather than implementing changes across all codes simultaneously.

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?

Drax agrees that the filtering decision should reside with the relevant panel. Drax agrees that there may be merit in there being an Ofgem veto, although this should be *time limited* and subject to set usage criteria.

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 general criteria for classifying modification proposals appear reasonable.

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

Drax believes that the proposed mechanism to redirect a modification between Path 3 and Path 2 seems reasonable, although careful consideration should be given to the process for changing the path. It would be detrimental to have a process that allows a given modification to change path repeatedly; it would be a very inefficient use of resources if the Terms of Reference for a given modification were to change repeatedly.

Given the filtering process that would take place when a modification is raised, and the type of modification that is expected to be allocated to Path 3, both the relevant panel and Ofgem should have the ability to instruct a change of path from Path 3 to Path 2. However, such a change of path should be time limited and subject to set criteria.

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?

As mentioned in our previous response, Drax does not view a moratorium on new proposals that fall within an existing MPR to be acceptable. Drax believes that there may be instances where (a) parties have been unable to take part in an MPR process (say, due to resource), but believe that they have a valid solution later in the process, or (b) a solution may only become apparent after the original proposal has undergone substantial development.

The inability to raise a new modification that addresses an issue covered by an MPR process would lay to waste one of the main benefits of the current code modification processes, namely the ability to propose a solution to a defect at any time regardless of the size or resource of a given party. The moratorium may work to the advantage of those industry participants that have significant regulatory resources, as these parties are likely to be heavily involved in a review process from the beginning.

Finally, it is important to ensure that all proposals that are subject to an MPR-style process are considered thoroughly by a modification group. The new arrangements should attempt to avoid a repeat of the recent situation under the CUSC modification process where multiple, highly contentious modifications were given urgent status with little or no consideration by an industry working group.

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?

As mentioned earlier in this response, Drax believes that a process to facilitate industry discussion and allow parties to make informed judgements on how best to raise modifications may be a more proportionate response.

Regardless of the process adopted, we agree that the process should retain some flexibility in order to reflect the nature of the modification / perceived defect in question. However, it would be more conducive to better regulatory practice if the proposed process was defined prior to implementation; such a process must be flexible in design, as Ofgem have indicated, but nonetheless defined in a clear and concise manner. The current modification processes under the BSC and CUSC have the flexibility to afford a modification the time and resource it requires on an individual basis; there is no reason why a new process to facilitate industry discussion could not be constructed in a similar fashion.

Drax believes that any such process should be developed and defined in conjunction with industry stakeholders.

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

As Drax commented in response to the previous consultation, we believe the outcome of facilitated industry discussion / an MPR-style process should be a document that contains clear industry guidance on the elements of a modification that may be beneficial (with full justification) in helping to rectify the perceived defect(s). We do not believe that the outcome should contain inflexible directions on how a particular problem should be solved, nor should the industry be obstructed from raising new modifications that may solve the perceived defect in a more efficient manner.

Whilst we believe the regulator should be able to identify perceived defects and facilitate industry discussion, it should be signatories to the industry codes that raise modifications to the rules and procedures that govern their connections, trading, metering and settlement systems. The current code structure works in a way that aims to find the most efficient outcome for the industry as a whole, with the appropriate checks and balances to ensure no single user is subject to discrimination and that the end consumer is protected (particularly if consumer representatives have the power to raise modifications).

Drax believes that the relevant code administrator should have the ability to raise a new modification (where there is an appropriate, quantifiable justification) on behalf of the industry, with the outcome of the facilitated industry discussion process being used as guidance when developing such a modification. For the avoidance of doubt, Drax does not support “legally binding” conclusions or obligations to raise modifications; if it is in the interest of consumers or the relevant code objectives to raise a modification, then an industry party, code administrator or consumer representative would be in a position to make that judgement and raise a modification upon concluding facilitated industry discussion.

Drax believes that it is important that the regulator is not placed in a position where it is unable to make an independent decision, resulting in it being increasingly left open to legal challenge. This would not be conducive to an efficient change process, nor would it be good value for consumers.

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?

Drax believes that industry participants, code administrators and consumer representatives should be able to raise modifications using the outcome of facilitated industry discussion for guidance. However, we do not support the suggestion that Ofgem should be able to draft modifications if the industry fails to do so. See our answer to Question 2 above.

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

Drax believes that any process / path that delivers a decision or, in the case of the current MPR proposals, legally binding conclusions as an outcome *must* be open to an appeal process via the Competition Commission at the time that the decision / conclusions are communicated.

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?

No; Drax believes that the ability for any party to identify a potential alternative solution to a defect, regardless of what stage the process has reached, is a credit to the current system. Further to this, the proposal to allow Ofgem to veto new modifications at any stage of the process is most unwelcome.

We are surprised at Ofgem's suggested power to turn down the consideration of alternatives that are “insufficiently developed”. This could potentially block those parties that do not have the resource to develop and provide analysis for a suggested alternative from raising potential solutions. The ability for a party to raise a modification or alternative with only a basic level of detail is a fundamental necessity of an “all-inclusive” system; this is a feature of the industry codes that should be safe-guarded.

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

Ofgem must be very careful in considering when such an action should take place. The ability of the regulator to change its conclusions may be very useful, particularly in situations where new analysis becomes available or Government policy changes. However, regular or multiple changes to conclusions may only serve to undermine such a process, in terms of the inefficient use of industry time, the cost of reworking modifications and / or analysis (to industry parties and consumers), and the added burden of greater regulatory risk.

It would also appear contradictory to allow the regulator to change its conclusions due to new information coming to light, whilst simultaneously holding a power to block industry participants from raising new modifications if *they* obtain subsequent new information.

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?

See our answer to Chapter 3 Question 3 above.

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?

Drax welcomes Ofgem's thoughts on the right of appeal; we believe that all signatories to a given code should have the right to appeal. The grounds to appeal appear reasonable.

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?

As the self-governance proposals currently stand, it seems reasonable for Ofgem to act as the appeals body. However, we do not believe that Ofgem should be able to exercise discretion over which appeal it wishes to hear and which it does not; it should be a signatory's right to have their views heard.

Finally, Drax believes that every path (including the self-governance path) should allow a party to take the final decision to the Competition Commission for an appeal based upon the merits of the case (if they so wish).

Appendix 2: Impact assessment

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

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

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

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

Drax believes that the proposed MPR process / procedures are insufficiently defined to be able to assess the reforms against the potential for cost savings as a result of implementation. When a final proposal is put forward by Ofgem, will we be able to consider a more accurate picture of potential cost savings as a result of code governance reforms.