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Dear Andrew

Code Governance Review: Major Policy Reviews and Self Governance

In our response to the December 2008 consultation document E.ON UK offered support for greater self governance and tentative support for an Ofgem led major policy review (MPR) process provided the right checks and balances could be put in place.

It is clear that Ofgem has sought to address a number of key concerns raised by market participants in responses to the previous consultation and helpfully filled in some further details about the MPR and self governance processes. Unfortunately the checks and balances outlined so far either do not go far enough or new concepts, such as the "time window" for raising industry alternatives, the changes to the code Panel membership and voting rights present new challenges to good governance. In our detailed response to the individual consultation questions below we suggest a number of further safeguards that could be adopted (these are also summarised in Appendix A attached).

We accept that with the right safeguards a new Ofgem led major policy review (MPR) process could potentially offer benefits in terms of more transparent and efficient decision making[1] for public policy issues. However, it also poses a great risk to the market if the process were to be used to drive inappropriate interventions. In our view inappropriate interventions[2] might arise from a well intentioned perceived "need to be seen to do something" perhaps driven by short-term political pressures or the pursuit of highly theoretical proposals that have little support from the industry, customers and other relevant stakeholders. To address this risk we think it would be

[1] Smart metering is one such area where a MPR process could be applied and its application to reform of independent gas transporter (IGT) arrangements and the governance of settlement systems managed by xoserve could significantly improve the effectiveness of supply competition in gas.

[2] Areas where we believe Ofgem's use of a MPR would be highly detrimental include mandatory day-ahead power auctions, as well as shorter balancing periods and introduction of entry/exit flexibility capacity arrangements in gas.

best to set out the MPR process and key safeguards within a statutory framework as this would give Ofgem a clear mandate for their new powers. Safeguards might include obliging Ofgem to seek permission from Government to carry out a MPR in the first place. The Secretary of State for Energy and Climate Change would therefore formally instigate a MPR following such a request on a case by case basis. This approach may also help better align Ofgem's work with that of DECC.

Fundamental changes to market rules can originate from bilateral discussions between Ofgem and the relevant regulated network business, and more often than not cover issues that are more relevant to network users and their customers than the network businesses themselves. Agreeing high level policy principles with the network business in this way[3] has been the source of a a number of legal challenges and regulatory difficulties in the past. It is this fundamental weakness in the regulatory regime that the MPR process could address. If the MPR process were to be a transparent, open, multi-lateral negotiation many misunderstandings between network users and Ofgem could be avoided. It would also be highly beneficial if the relevant monopoly network business were genuinely able to express their views without fear that that a failure to promote an Ofgem originated rule change might undermine their ongoing regulatory relationship.

Introduction of new powers though network operator licence changes

We still have significant misgivings about Ofgem seeking to introducing such fundamental change through changes to licences of the relevant network business. Ofgem seem to wish to use this vehicle to (a) give itself new powers, (b) delegate some decision making powers to the industry, (c) constrain industry rights to propose change during a MPR and (d) alter the constitution of Panels and each of these factors may directly or indirectly influence parties' statutory rights to appeal certain Ofgem industry code modification decisions. It is hard to see how Ofgem can legitimately make a decision to acquire new powers, or rebalance the rights and powers of others in this way especially as those that are most affected i.e. users (generators, shippers and supplies) have no formal right to object to such licence changes To avoid the risk of legal challenge and to establish a robust framework for the MPR process going forward we therefore believe it would be best to enshrine the MPR concept within legislation.

In defending its decision to implement UNC116V, at the Competition Commission in 2007, Ofgem sought to distance itself from the licence conditions it had placed on gas transporters requiring them to bring forward and support proposals to implement the enduring gas offtake arrangements as a condition of National Grid's sale of four gas distribution networks (GDNs). We are puzzled as to why Ofgem now feels it is appropriate to adopt a similar approach for MPRs going forward. In addition we are led to believe that the proposal will go even further than licence changes applied during the GDN sale – rather than placing an obligation on the licensee to bring forward a <u>particular</u> set of MPR conclusions (giving the network licensee (but not users) the right to object an issue specific licence change) it advocates a one off 'constitutional' licence change that would require the relevant licensee to bring forward proposals for all, future, as yet unspecified MPR conclusions. This is highly irregular. Such a 'constitutional' change could be seen to go beyond the powers and duties vested in the Authority by Parliament. We understand

[3] Examples have included the enduring gas offtake arrangements agreed as a condition of the sale of gas distribution networks, user-pays and entry trade, transfer and substitution arrangements in gas as well an Ofgem cash-out review leading to the P195 proposal and more recently certain transmission access review (TAR) proposals and CAP170 which seeks to apply administered prices for mandatory intertrips in electricity.

that Ofgem is currently working on legal drafting of licence changes designed to implement the MPR and self governance processes, so we will reserve our detailed comments on the legality and appropriateness of these changes until then.

Checks and balances and the impact of the latest proposals on the statutory code modification appeals process

A number of Ofgem latest proposals seek to address concerns expressed about checks and balances and the dangers of prejudicing statutory rights of appeal for certain code modification decisions. We are pleased that Ofgem is no longer suggesting that the relevant Panel should be obliged to bring forward modifications to implement "legal binding conclusions" of a MPR and have now said that that this would instead be responsibility of the relevant licensee(s), under which a particular industry code(s) is constituted. This goes someway to allaying our fears about Panel members being obliged to vote for what is an effect an Ofgem originated proposal, but of course the relevant licensee(s) that are obliged to bring forward proposals will still be required (or at least feel obligated) to vote in favour[4] of the MPR proposals that they have brought forward. Clearly, good governance mandates that the relevant licensee would have to declare an interest in the decision and abstain from the Panel vote.

Ofgem also proposes the creation of 'indpendent' chairs (appointed by Ofgem) for the CUSC and UNC Panels as well as voting customer representatives where these do not already exist. Clearly any changes to the Panel structures by definition will affect potential rights of appeal to the Competition Commission as such appeals are only allowed under certain circumstances where the Ofgem decision does not concur with the Panel recommendation. Unfortunately without the detailed legal text for licence changes it is difficult for us to fully evaluate the concerns or indeed assess whether our concerns are justified or not.

Ofgem indicates that it has met with the Competition Commission to discuss its latest proposals, to gauge whether it thought the MPR process would undermine the appeals process. We are told that the scope of an appeal would not be restricted by any MPR conclusions should this be relevant. This may well be true but we have seen from the UNC116V/UNC116A appeal that the Competition Commission will naturally be deferential to the opinions of the competent authority Ofgem;

Paragraph 5.11 of the UNC116 Appeal Decision states;

"As a specialist appellate body charged with considering whether a decision of GEMA is wrong, the function of the CC is to provide accountability in relation to the substance of code modification decisions. However, leaving to one side errors of law, it is not our role to substitute our judgment for that of GEMA simply on the basis that we would have taken a different view of the matter were we the energy regulator. We make that clear in our Guide to Appeals in Energy Code Modification Cases (CC11, July 2005) paragraph 2.2. The Energy Code Modification Rules (ECMR) also make clear that we will proceed by way of a review of the decision subject to appeal, not a rehearing. In our view, the

[4] The concern arises where the relevant network operator licensee(s) have a vote on the relevant code Panel, including the CUSC Panel and the UNC Panel. It is of particular concern under the UNC where transporters hold half the votes and distribution related MPR proposal may have to be brought forward by four of those transporters. Under the enduring offtake arrangements the right of appeal to the Competition Commission for UNC116V and UNC116AV was achieved in part because competing proposals split the transporter vote.

approach adopted in our Guide, and reinforced by the ECMR, is consistent with the nature and complexity of the issues in code modification appeals, and the short period of time allowed for the appeal process."

In our view this means that the Competition Commission will tend to give Ofgem the benefit of doubt and we believe they will be inclined to accept the conclusions of a MPR at face value rather than scrutinize the decision too thoroughly, especially given the severely constrained timetable of 12 to 15 weeks for the appeal process. The MPR conclusions may not be said to pre-judge the outcome of an eventual modification decision but it will in our view limit the willingness of both Ofgem and the Competition Commission to dispassionately evaluate the merits of each modification proposal presented to it. Even where the evidence presented to the Competition Commission were to be similar in scope to that which would have been submitted under the current regime, the existence of this new MPR process will in our view effectively reduce the chances of a successful merits based appeal. It would be helpful if the Competition Commission could articulate its views on the MPR process and its possible impact on the statutory code modification appeals process.

Ofgem has also taken on board a number of our concerns regarding restricting the rights of parties to bring forward proposals during a MPR. Unfortunately the proposed solutions only partly address these concerns and some of the solutions proposed either create further problems or involve Ofgem taking on further powers. The "time window" for industry to propose alternatives that they believe better meet the MPR conclusions is clearly better than a moratorium on proposals during a MPR. Nevertheless even this would represent a significant curtailment of the rights of industry participants to propose changes at the time of their choosing. Whilst Ofgem is suggesting that urgent proposals will still be allowed at any time, the granting of urgency remains a matter for Ofgem.

In the Code Administrator Working Group (CAWG) discussions we put forward the concept of "rights for the modification proposer[5]". This concept is about ensuring that the modification process and the way in which it is managed does not undermine the integrity of the proposal ensuring that it is "owned" throughout the process by the proposer. The CAWG achieved a high degree of consensus on this point with particular support from small players. At the heart of this concept is the modification proposer should have the right to have his or her undistorted proposal eventually presented to the Authority for a decision. We saw this as a fundamental right in the regime that must be preserved.

Unfortunately the processes described in the latest consultation document seem to fall foul of this principle. Our particular concerns are as follows;

a) Proposals deemed by Ofgem to fall within the scope of the MPR would be subsumed into that process, and in so doing rejected but without consideration of the specific merits of that proposal. We cannot see how Ofgem can reject a proposal at this stage before any assessment of this specific proposal has taken place or prior to any Panel recommendation - this would surely be tantamount to pre-judgment.

[5] http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/CAWG/Documents1/CAWG2_Eon%20presentation.pdf.

b) The ideas contained in the rejected modification may be incorporated into the MPR process but this is unlikely to be in the exact form specified in the modification[6].
c) Also no new proposals would be allowed whilst awaiting an Ofgem decision[7]. At worst a delay to an Ofgem decision may prevent industry parties bringing forward further proposals that continue to fall within the scope of a MPR.
d) In addition it appears proposals would not be permitted if a modification to implement the MPR conclusions was subject to a Competition Commission Appeal or the matter had been remitted[8] back to Ofgem.
e) Furthermore it is unclear whether a proposal that did not meet the MPR conclusions would be permitted as an alternative.[9]

Overall we do not believe that Ofgem can reasonably seek to constrain when industry participants are able to bring forward proposals. We do not see why it needs to do this anyway. It already has almost[10] complete discretion over the timing of its own decisions and can intervene to speed up or slow down the consideration of particular modification proposals under the existing industry code modification procedures. It is therefore already able to manage the process to suit its own organisational convenience (albeit with some difficulties at times).

In our view constraining industry participants' rights to propose modification proposals is contrary to good governance principles. It assumes Ofgem's own agenda and organisational needs are paramount, whereas democratic processes require the balancing of the rights and needs of all players involved in the process.

Ofgem also suggest a new right to change "directions" on MPR conclusions if for example new information comes to light. On the face of it this may seem to be a reasonable proposal, however we do not quite see its relevance. It all depends how "binding" the MPR conclusions are intended and who they relate to. If they require the relevant licensee(s) to bring forward revised proposals it may be reasonable, but that surely means that the clock starts again on the time window to allow other parties to propose new alternatives.

We think a more pragmatic and efficient process is to continue to allow parties the freedom to bring forward proposals at a time of their choosing. If they are allowed to, we think that the industry will almost certainly bring forward proposals taking into account the new information so we think that the right to change "directions" is not required.

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[6] Matters of profound importance to an individual market participant could easily side-stepped whereas under the current arrangements there is an expectation that the regulator will be obliged to opine on their specific proposal.

[7] In many cases decisions on modifications that originate from a MPR are likely to be controversial. It would be untenable if parties were unable to put forward proposals simply because of the delays arising from difficulties faced by Ofgem in making a controversial decision. One only has to consider the delays to the decisions on zonal transmission losses (P203 & P205) or transmission access (CAP148). Furthermore it is perfectly possible for credible new ideas to come forward at a late stage. The P217A cash-out proposal t approved last year is a case in point. In our view this could only have been proposed relatively late in the day because the analysis on which it was based arose out of debates on other specific modification proposals (P211 and P212).

[8] UNC195AV which was approved by Ofgem sought to address the matters raised by the Competition Commission when it remitted UNC116A/UNC116Vdecision back to Ofgem. The latest Ofgem proposals appear to prevent industry participants putting forward such alternative proposals in future. E.ON believes UNC195AV and the industry processes that led to it facilitated an early satisfactory resolution to the enduring offtake arrangements controversy something that may have been more difficult if Ofgem had simply revisited its decisions on UNC116A/UNC116AV

[9] Our concerns here relate to situations where Ofgem's MPR conclusions might preclude viable proposals being brought forward. If a MPR process had existed at the time of the Transmission Access Review (TAR) Ofgem could have for example conclude that auctions or other related 'value based'rationing mechanism was the only way forward. Under such circumstances would "Connect and Manage proposals be within scope?

[10] Ofgem's latest proposals on the timing out of code modification decisions would make its decisions open-ended.

Our detailed responses to the consultation questions are set out below.

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?

We agree that code governance arrangements need to evolve to deal with the challenges of climate change and security of supply. Discussions on Environmental Guidelines for example and in particular the work of the cross-code Standing Group established by the CUSC Panel show that the current arrangements and code objectives can accommodate can could reasonably permit assessment of environmental issues. The considered view of the Standing Group was that it was perfectly feasible for the CUSC amendment process to undertake an assessment of the impact of the proposal on GHG emissions under the "efficient and economic network operation" objective and that wider environmental assessments may be possible under the general code objective referring to "efficient discharge of the relevant licensee's activities".

However we are not persuaded that that there are fundamental weaknesses in the current structure or governance of industry codes. There are clearly many beneficial improvements that can be made to the codes and E.ON UK is keen to see where best practice can be identified, for this to be adopted more widely. In this regard we have put forward a number of ideas as part of the Code Administrators Workgroup that we believe will benefit all code signatories irrespective as whether they are large or small players[11].

We agree that the existing code modification processes have worked well for incremental reforms, but it has also proved perfectly possible to implement radical reform that has had a significant impact on market participants when there has been general support for change or change is championed by a particular player such as National Grid. The current arrangements were specifically designed to allow code signatories and not regulators to propose changes and the current flexible governance processes facilitate 'evolution' rather than 'revolution' of the current market arrangements. More strategic public policy issues have traditionally been driven through to implement the fundamental changes brought about by NETA and BETTA .
We do not believe the MPR framework as currently described is a proportionate response to the 'problems' identified by Ofgem. We would have hoped for process design that was more holistic and facilitated partnership and dialogue between Ofgem, network businesses, network users and customers. Unfortunately the current proposal seem to create a separate, Ofgem process 'bolted-on' to the front of the existing industry modification process. We think that when this is combined with Ofgem's tighter controls over the industry run process, the inevitable consequence will be further disengagement of Ofgem and industry participants in the code modification process.

[11] For example we have stressed the importance of proposers retaining "ownership" of their proposals during the modification process as this gives proposer confidence that their proposal will be presented to Ofgem for decision without distortion. This clearly also relies on an effective process for consideration of viable alternatives that may be favoured by others to be considered in parallel.

If industry participants conclude that their role is secondary or simply just about implementing the will of Ofgem they will become less active in the modification process. We fear that this could ultimately reduce the quality of modifications developed in the process. Also Ofgem may see even less need to participate in industry meetings as they can effectively intervene as any time in the industry modification process if they are not satisfied with the direction it is following (e.g. through new "send back" and "call in" powers).

The reality is that Ofgem origination of proposals together with tight control of the industry modification process and an effective weakening of the statutory code modification appeals process will enable Ofgem to better choreograph the outcome it wants. If this were to increase the chances of (inappropriate) interventions this would further add to the regulatory uncertain faced by energy companies.

We think it is right that affected parties and decision makers (whether customers, users, network businesses, Panels or Ofgem itself) should from time to time be unhappy with particular outcomes. In our view, if an organisation is consistently satisfied or dissatisfied with the process, it is probably not working properly. It is therefore important that individuals and the organisations they represent try to avoid being unduly coloured by recent (good or bad) experience of the code modification processes. In this context one has to question whether tilting the process so far in favour of Ofgem is desirable. It may well be appropriate, but it surely it is a question for Government to determine the extent of Ofgem's powers and not for Ofgem to decide for itself what powers it should have.

Despite our concern about MPRs, we continue to believe the self-governance part of the proposals are very welcome and we think it could provide significant benefits if some 50% of lower impact proposals could follow this path (as seems to be suggested by an earlier back-casting exercise). This would allow Ofgem's resources to be concentrated on higher impact proposals that have more relevance to competition and market efficiency.

In our view the self governance piece (Path 2 and Path 3) is self evidently the right thing to do and as such should be implemented as a matter of priority. As such we think it can be de-coupled from Path 1 (the major policy review piece) and we would suggest that Ofgem pursues this first to capitalise the obvious benefits of such reform as quickly as possible. This would then allow more time for a MPR process with robust checks and balances to be developed later.

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

This depends on the circumstances. Such a process is clearly better than originating major policy modifications from discussions between Ofgem and the relevant network business to which network users and their customers are typically not party to. Overall it certainly represents a much more, transparent, open and honest approach than the established practices which allow Ofgem to effectively pretend they are not the originator of a particular proposal when in fact they are.

When there is a consensus on the need for change or a substantial proportion of market participants/relevant stakeholders consider change is required the MPR process could work very effectively as there would be a large body of opinion prepared to agree with MPR "directions".

Where it becomes difficult is when Ofgem's views are at odds with the vast majority of the industry and other stakeholders and that is when it is important to ensure the processes that require licensees to bring forward proposal to implement the MPR conclusions do not undermine the efficacy of the Competition Commission merits based appeal process.

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

Yes we think so. However, real benefits will only be achieved if a significant proportion of proposals follow this route, and if this was to be around 50% as suggested by Ofgem's previous the back-counting exercise this would be very encouraging. There are doubts in some quarters however, whether Ofgem would really be comfortable in allowing this degree of self–governance. The latest proposals seem to suggest an increased reluctance on Ofgem's part to delegate more responsibilities to the industry which is disappointing. For example the new filtering criteria related to "non-trivial impacts" will , in our view, tend to reduce the proportion of proposals that could follow the Path 3 self governance route as Ofgem opts for Path 2 as a safe option.

The appeal route to Ofgem is clearly an essential safeguard as is the opportunity for a full merits based appeal to the Competition Commission if available. We are pleased that Ofgem has included the latter which was an omission in its previous proposals.

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

Despite our hope for more self governance we believe that the majority of proposals will continue to follow this route. It is therefore essential to retain the current processes more or less as they are now. It should however be an aspiration to minimise the use of Path 2 the Improved Status Quo path but only if this increases the number of proposals following the Path 3 self governance rather than the Path 1 MPR route.

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 think it should be limited to UNC, CUSC and BSC, as it is these codes that could benefit most from more self governance. It is also likely that these codes will be more likely to be subject to a major policy review.

Many of the other codes that are perhaps more procedural in nature and already have a degree of self governance so it is probably less pressing to introduce changes to these codes. Our preference would be to start with UNC, CUSC and BSC and then potentially roll it out, if appropriate, to other codes based on any experience gained.

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?

Yes, but we do not generally believe it is appropriate for Ofgem to change its mind during the process, although we would be less concerned about a decision to go from Path 1 to Path 2 or Path 2 to Path 3. We think that once a path has been determined it should be allowed to proceed along that path through to the decision stage.

Ofgem should give full and detailed reasons for filtering decisions and the Ofgem veto should be made within 5 working days of the proposal being submitted to the relevant code administrator.

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?

Overall the criteria outlined in the document seem reasonable although the new "non trivial impact critieria" will in our view increase the number of proposals that follow Path 2 rather than Path 3. It is important to remember however, that under the latest Path 3 self governance proposals appeal rights to both Ofgem and the Competition Commission may well be available so the application of the filtering criteria does not have to be based on an "if in doubt follow Path 2" approach

Unfortunately like all criteria of this sort they can always be subject to creative interpretation. Nevertheless, we would hope that the outcome would be say no more than 2 MPRs each year and at least half the remaining modification proposals following the Path 3 self governance route. In the main we would expect that the intent to carry out a MPR would be signalled well advance for example in Ofgem's 5 year plan.

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?

A moratorium of any kind is entirely inappropriate. There should be no restrictions on the rights of parties to put forward modification proposals during a MPR and in our view it is essential that the existing rules governing both non urgent and urgent proposals should continue to apply. We do not understand why it would make good sense (other than perhaps the organisational convenience of Ofgem) to restrict parties from putting proposals forward at any time. Parties can be profoundly affected by the rules set out in industry codes and changing market circumstances may affect their impact - limiting their ability to have a specific rule change considered because Ofgem has deemed an issue to be covered by a MPR would seem to fly in the face of natural justice.

At best such a curtailment of the rights of market participants to propose change, at the time of their choosing, risks stifling or at least stalling the ongoing evolutionary change process for which the code modification process is generally acknowledged to be effective. At worst the process of early rejection of proposals that are not considered urgent by Ofgem can be considered to be pre-judgment of the potential merits of such a proposal and therefore foregoing statutory rights of appeal that might otherwise be available to the proposer if the proposal was allowed to run its course under the normal code modification procedures.

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?

In principle yes. Unfortunately there is very little detail as to what the MPR process will really entail and what typical consultation process might be. The MPR is in reality a separate process from that of the industry code modification process. Unfortunately it is perhaps this compartmentalisation that poses the greatest risk to improving the quality, accountability and effectiveness of the over modification decision making process.

Many respondents to the last consultation emphasised the need for greater, active and early engagement of Ofgem in the existing code modification process and suggested that many of the suggested deficiencies of the current regime could be solved by greater dialogue and partnership. For example the "call in" and "send back" powers should not be necessary in a world in which there was full Ofgem engagement. Ultimately we fear that this two stage process will lead to further disengagement by Ofgem.

One cannot help but observe that Ofgem wants to reserve the utmost flexibility in its own MPR process but at the same time have complete discretion to intervene in the industry managed processes. In reality this seems to be about asserting end-to-end control over the whole modification process.

If such rebalancing of power towards Ofgem were to occur, it is essential that appropriate checks and balances are put in place to (a) determine who should instigate a MPR and (b) how a MPR should be conducted. It is clear from the consultation that Ofgem believe only 1 or 2 MPRs will be conducted each year. Given this, it would seem to us that these must almost certainly be matters of Public Policy such as say transmission access or smart metering and it would be more proper for any decision to instigate a MPR to rest with Government. That is not to say that Ofgem are not best placed to carry out the review, but such a safeguard would provide some protection against possible inappropriate interventions described earlier.

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

We understand that the outcome of a MPR will be key policy principles it is hard to see anything other than Option 1 "High Level Binding Conclusions" being feasible. Ofgem must of course be careful not give an impression of pre-judging its eventual modification decision so it would appear to be much safer for Ofgem to avoid the more prescriptive Option 2 and 3 approaches.

However, we would not object if Ofgem were to fully draft a proposal (although we are not sure whether in the more complex cases whether Ofgem would have the knowledge and expertise to do this) – it would then at least be perfectly clear who was the effective originator of the proposal.

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?

Yes, drafting of MPR-related code modifications sits best with the industry. It is possible that there might be a natural reluctance to draft certain proposals especially those that are known to have little support from network users, their customers and other relevant stakeholders. Nevertheless, the relevant licensee will clearly have a legal obligation to bring forward a proposal to give effect to the conclusions of a MPR. Ofgem having the power to draft a proposal as a back stop may be appropriate but we think it is most unlikely to be used in anger.

If Ofgem were ever forced to use this back-stop power it might well be an indication that the MPR conclusions were somewhat flawed.

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

Ideally a merits based appeal[12] should be allowed for all modification decisions that originate from a MPR. This would avoid concerns that may arise from panel members feeling obliged to vote in a particular way or questions about how chairs appointed by Ofgem can be seen to be independent.

The following series of safeguards however, could apply instead if it was still considered appropriate to have a recommendation on MPR related modification proposals:

(a) It should be made clear that all Panel members that are entitled to vote should consider each MPR related proposal entirely in terms of whether that proposal better facilitates the applicable/relevant objectives. No consideration should be given to how well the proposal does or does not meet the conclusion of an Ofgem MPR.

(b) Panel members that are entitled to vote should ideally be be required to declare whether they are in a position to freely cast their vote without fear, risk of sanction or relevant legal impediment[13]. In fact such an obligation should apply to all Panel votes whether or not such votes are related to proposal originating form a MPR.

(c) We consider that any network licensee that is required to bring forward a modification proposal to implement the conclusions of a MPR and has voting representation on the relevant Panel should not be able to vote on Panel business that relates to that particular proposal and any related alternative proposals. Otherwise such parties will inevitably feel

[12] This may be feasible within if the Panel were not to make a recommendation in relation to modifications that arise from a MPR. The Modification rules could specifically exclude making the Panel making a recommendation in such circumstances.
[13] Panel members should not be placed under undue pressure to vote in a particular way from any individual or organisation,

obliged to support the proposal that they have been directed to bring forward[14] and oppose some or all of the alternatives.

(d) Similarly any 'independent' panel chair appointed by Ofgem, or other voting representative appointed to a panel by Ofgem or indirectly by the 'independent' panel chair should not be entitled to vote on panel business related to proposals and alternatives arising from a MPR.

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?

This clearly better than an outright moratorium but is still unacceptable. Please see above for a detailed explanation as to why we believe this is unacceptable.

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

On the face of it yes, but for the reasons given on page 6 we do not think this is necessary if Ofgem allows the industry to bring forward proposal which will most probably take account of changing circumstances.

This new right may be viewed as giving Ofgem the power to change its mind if they are uncomfortable with the direction of modification developments after first issuing their original MPR conclusions.

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?

Given the current structure only permits code signatories and in some cases Consumer Focus to propose changes to each code we naturally think this is the only proper route for facilitating both self-governance and MPR changes.

The asking of this question in this way however, does seem to imply a change in Ofgem's previous stance. In the last consultation Ofgem had suggested the MPR and self-governance reforms were "a package", whereas we thought the down-side of the MPR process (as then defined) outweighed the benefits of the self-governance. The overall package did not appear to represent a good deal, but we thought it perfectly feasible and desirable to pursue the self-governance reforms separately in their own right.

We would have expected Ofgem to seek to drive forward the complete MPR and self-governance package through prescriptive changes to the licensees of the relevant network businesses under which the codes are constituted. Although we clearly believe this is an inappropriate vehicle for facilitating such change, the apparent suggestion of a two track approach could be viewed as a

[14] In the case of the enduring offtake arrangements each gas transporter was compelled to support at least one of the UNC116 proposals,

sign of lack of Ofgem commitment for the self-governance reforms. This may mean Ofgem gets the reform it really wants (i.e. MPRs) through licence changes and then self-governance changes may follow much later though the normal code modification process, but with no guarantees that such changes will eventually be approved by Ofgem. If this is indeed the approach suggested it would be the worst of all worlds.

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

No. The appeals processes should provide appropriate safeguards for affected parties. Please also see our comment on page 9above.

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 – it is entirely appropriate for appeal rights to apply equally to all code signatories. We are pleased that Ofgem acknowledge that a full Competition Commission merits based appeal could be available in cases where Ofgem make a decision following an appeal to it in the first instance

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 these proposals seem reasonable.

Appendix 2: Impact assessment

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

We agree the proposals may marginally reduce the number of piecemeal modification proposals and the need for multiple impact assessments, although Ofgem already has the freedom in most cases to align decisions on modification proposals though the timing of decisions and directing the pace of assessment of proposals.

As for duplication of analysis, we find it hard to believe much definitive analysis can take place at the MPR stage as detailed modifications would not typically have been defined as part of that process, and alternatives may well be brought forward. We think detailed Ofgem impact assessments can only realistically take place once these modification proposals are on the table. If any detailed analysis is conducted at the MPR stage this surely would have to be revisited[15] later on – if it is not and Ofgem were to unduly rely on its earlier MPR analysis it may be perceived to have prejudged its decision on a particular modification proposal. In our view the new compartmentalised structure (an Ofgem MPR followed by the industry modification process) is more likely to waste resources as previous analysis has to be revisited.

[15] This was the case in respect of the enduring offtake arrangements where arguably "MPR type" conclusions were made at the time of the sale of gas distribution networks and more detailed impacted assessments carried out later once modifications had been brought forward.

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

The cash-out example is used to illustrate the potential cost savings that might arise from the MPR process. Although we consider that this is a poor case-study to choose we consider the quantification (£1m) could reasonably reflect the cost savings arising from a typical MPR. Where we differ from Ofgem is potential costs that may arise from inappropriate interventions. This is where the cash-out example is helpful as we think this is a good illustration of the cost of inappropriate intervention[16], £2m to use Ofgem's own figures. Thus in our eyes one might need one inappropriate intervention to offset the direct cost savings of two appropriate interventions. This does not take account of the added regulatory risk that may arise from increased (inappropriate) regulatory interventions. Thus the cost will depend how the Ofgem choose to use the MPR process and also the checks and balances in the regime designed to improve the transparency and accountability of the code decision making process.

The suggested Ofgem cost saving from the self governance reforms appear reasonable, but it must be remembered that resources will simply be shifted onto the industry process instead Thus overall direct costs saving are unlikely to be significant. We think savings will nevertheless be achieved from improving the speed of decision making. Regulatory uncertainty will also reduced as industry processes for the routine low impact proposals can be managed within the framework of a disciplined, time bound industry process. No longer will these proposals be competing for attention with the higher impact proposals that will continue to be presented to Ofgem for a decision.

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

There may be some additional benefits from a more coordinated process that would allow greater and more effective customer participation. We are not convinced that necessary reforms will be expedited any faster, in fact the compartmentalised two stage Ofgem MPR process followed by the industry code modification process may in fact lengthen the decision making process and duplicate analysis. Any misuse of the MPR process for inappropriate interventions could have a significant detrimental impact on consumers. Competition will only be enhanced if MPRs provide properly target and proportionate solutions.

Renewable generators and the specialist trade associations are very effective in lobbying already. To the extent that such parties are not big six players these proposals may make it slightly easier for such parties to engage in the process,

[16] In our view P217A is likely to produce similar cash-out prices to the pre P195 regime. Most BSC parties were reasonably content with the pre P195 cash-out regime. It is our understanding that the near marginal P195 proposals came about from discussions between Ofgem and National Grid. If P195 had not been implemented we do not believe the subsequent proposals leading to P217A would have followed.

We are be keen to work with Ofgem to see how best to implement these reforms. With further detailed definition of the MPR process and in particular greater emphasis on appropriate checks and balances to ensure accountability and transparency of decision making we could be persuaded to offer fuller support for the Ofgem proposals.

Please feel free to give me a call if you wish to discuss the views set out above.

Yours sincerely

Peter Bolitho
Trading Arrangements Manager

Appendix A: Summary of suggested checks and balances for major policy reviews (MPR) and self governance proposals

1. New powers to conduct a MPR should be set out in primary legislation with details set out in a statutory instrument (this might be similar to the framework for statutory appeals process for industry code modification appeals).

2. Permission to conduct a MPR should rest with the Secretary of State for Energy and Climate Change.

3. It would be expected the MPR process would be managed in line with Better Regulation Executive guidelines, including the usual 3 month consultation period.

4. Existing rights for code signatories to propose modifications (both urgent and non-urgent) shall continue during any MPR. There should be no moratorium or restricted time window for industry participants to propose modifications during a MPR.

5. If a network business is required under its licence to bring forward particular proposals to implement MPR conclusions and has a representative on the relevant panel then it shall not be permitted to vote on any Panel business[17] relating to such a proposal or related alternative proposals.

6. Should 'independent' chairs be appointed[14] by Ofgem to a panel they shall not be permitted to exercise a casting vote in relation to any modification business (including alternative proposals) arising from a MPR.

7. Similarly, any panel members that are appointed to a panel by the 'independent' Chair or customer representatives (where they are appointed[14] by Ofgem) shall not be permitted to vote on modification business (including alternative proposals) arising from a MPR

8. Each Panel member shall be required to declare particular circumstances that could fetter his or her discretion [18] in carrying out his or her duties, and therefore potentially make the Panel decision making process unfair. This would extend beyond any declarations of conflict of interest that may already exist under the relevant code but would include a declaration of any legal obligations that require parties to support or oppose certain decisions (e.g. licence obligations, agreed health and safety rules etc) or where a Panel member considers he or she has been placed under undue pressure to vote in a particular way. Such declarations shall be recorded in the relevant Panel meeting minutes.

9. Ofgem rights to "send back" or "call in" proposals shall include full reasons for such a decision.

[17] Voting on modification business includes Panel recommendations but also matters related to management of the modification process which might otherwise be prejudiced by a particular party's licence obligation to bring forward a proposal to implement a MPR conclusions. It would also be important that any persons directly appointed by Ofgem or indirectly appoint by Ofgem appointee are safeguarded from accusations that they favoured an Ofgem originated proposal, and by voting in favour could potentially limit affected parties' statutory right of appeal.

[18] Ideally all Panel members should be free to use their discretion and experience to consider matters in a dispassionate manner based on the evidence available to them. There may be circumstances where Panel members feel obliged or are placed undue pressure to vote in a particular way. The proposed declaration is about ensuring fair play within the modification process.

10. Ofgem shall be entitled to request (but not direct[19]) new implementation dates for code modifications and again full reasons for such a decision shall be given.

11. Should Ofgem fail to make a decision on a modification within [2 years][20] of receipt of the final modification report then the relevant Panel recommendation shall be adopted as the Ofgem decision. Where a Panel recommends implementation of a number of competing proposals then their preferred solution i.e. the one that best meets the applicable/relevant objectives shall apply.

[19] See E.ON's responses to Ofgem consultations on the timing-out of modification decisions.
http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/E.ON%20response%2051%2009.pdf
http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/E.ON%20response%2051%2009.pdf

[20] The current open-ended decision making process for code modification decisions is a major source of regulatory uncertainty. A suggested figure of 2 years is extremely generous.