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18 September 2009

Dear Andy

Major Policy Reviews and Self Governance - Initial Proposals

Executive Summary

- We support in principle a governance process which allows the consideration, production and implementation of major policy issues in a robust and efficient manner.
- We do not consider that Ofgem's current proposals contain appropriate regulatory checks and balances given the increased powers provided to Ofgem to direct change.
- It is not acceptable for Ofgem to reserve the right to impose on the industry a fully drafted code modification change (as set out in option 3) as a means of implementing the outcome of MPRs.
- If Ofgem, despite strong industry opposition, implement such a power, then this is such a new and radical change to the current regulatory arrangements that it warrants additional and robust checks and balances, including new rights of challenge. For example, code parties should be able to formally object (with associated blocking thresholds) to any direction issued by Ofgem following the completion of an MPR similar to that used in the collective licence modification process.
- We fully support the proposals on self governance, as the efficiencies derived will deliver benefits to all parties and ultimately customers.

General

EDF Energy welcomes and supports the concept of a process which allows the consideration, production and implementation of major policy issues in a robust and efficient manner. This support is extended to the Self Governance proposals, as the implementation of the majority of measures contained within these proposals will deliver streamlining and efficiency benefits. However, other aspects of the Major Policy Review (MPR) proposals require further development to ensure that the appropriate checks and balances are in place. It is not acceptable for Ofgem to reserve the right

(i.e. option 3) to impose change (having already drafted the code modification and legal text) without adequate consumer/industry contribution and oversight to major change development. In our response to the first consultation on MPRs we provided our views on the potential risks associated with Ofgem taking on the role of “Judge, Jury and Executioner”. Those risks remain valid today, given that Ofgem has to date given no comfort or proper explanation as to why these concerns may be unfounded.

Major Policy Reviews

We continue to support Ofgem’s view that a more coordinated approach to the delivery of strategic change would be beneficial to market participants and to consumers. It is therefore regrettable that the Initial Proposals document fails to deliver sufficient detail on the mechanics of how an MPR would operate. For example, there appear to be multiple opportunities for MPRs to be initiated outside of the Ofgem Corporate Strategy process. While we can understand the attraction of a “flexible” MPR process, it is imperative that appropriate and transparent governance frameworks exist, in order to ensure MPRs are only triggered when it has been adequately demonstrated that there is a robust, justifiable requirement to do so.

Market participants would be subject to significant regulatory risk as a consequence of an MPR being inappropriately delivered, which could result in unacceptable investment risks. There could also be a risk of regulatory interference in established property rights, which would again undermine investors’ confidence in the arrangements. Ofgem needs to demonstrate its commitment to enhancing market arrangements to benefit competition and consumers without imposing unnecessary risk onto market participants. We recognise that there needs to be a mechanism by which major, strategic policy issues can be progressed via an appropriately developed MPR process, as this could deliver real benefits. However, any increase in regulatory control over the code modification processes requires appropriate checks and balances to be a fundamental part of the governance process, in order to protect market confidence and reduce the potential adverse impact on the market. We would therefore recommend that more work is undertaken with the industry, in order to determine how the MPR process can be developed into a credible and fully transparent regulatory process.

If an MPR process is to become part of the regulatory tool kit which Ofgem has at its disposal, the following points represent a high level view of some of the changes which need to be made:

1. Potential Major Policy Review topics should be discussed with the industry in advance of their inclusion within Ofgem’s Corporate Strategy and any other Ofgem Corporate Communications. This would provide the opportunity for robust challenge and discussion in a collaborative environment, either at Code Panel Meetings, Powering the Energy Debate stakeholder sessions or smaller stakeholder group meetings.
2. Effective and transparent communication mechanisms need to be established between Ofgem, the Government and industry that are visible to market participants. If an MPR is being proposed as an answer to a Government Policy objective, that objective must be publicised in advance of an MPR being triggered
3. A legal right should be established for market participants to challenge any direction issued by Ofgem following the conclusion of an MPR; this could take the form of a mirroring of the Collective Licence Modification process.
4. A clear governance process that Ofgem will follow when instigating and undertaking an MPR needs to be developed and published. This process

should be appropriately drafted to provide assurance to the industry that regular sense checks are undertaken to ensure an MPR is still required. In addition, Ofgem should consult on any proposal to initiate an MPR prior to make any formal decision.

5. If an MPR is to be developed through industry meetings, we propose that there should be an independent chair. An important question to consider is whether Ofgem, DECC or someone else is the appropriate body to appoint this chair.
6. Ofgem needs to be clear how Licence holders will meet their requirement to raise modification proposals. We do not believe it should be through the raising of a fully developed modification proposal ready for consultation. Rather, it should be the case that a modification proposal will be raised, which will then progress through the assessment and development processes that are present in all of the codes.

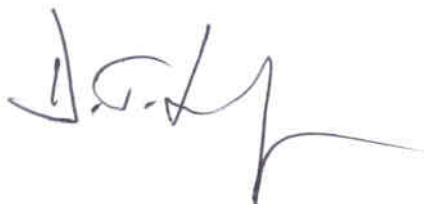
Self Governance

We welcome the move to embed enhanced self governance processes within the industry Codes. This has proved to be extremely effective under the auspices of the Master Registration Agreement and the Supply Point Administration Agreement. Code Panels should be making the decisions on the majority of technical, non-strategic modification proposals raised. We agree that enhanced self governance processes should be applied across all Codes, as the efficiencies derived will deliver benefits to all Code parties and hence to customers. The development of enhanced self governance processes can and should be progressed independently of the implementation of the MPR process.

In summary, we welcome the strategic approach Ofgem is taking with regard to reforming the industry Code arrangements and generally support in principle some of the reforms set out within this consultation. We have responded to the specific questions in the attachment to this letter.

If you require any further information or would like to meet with us in person to discuss our response, please do not hesitate to contact Rosie McGlynn on 07875 111 488 or myself.

Yours sincerely

A handwritten signature in black ink, appearing to read 'D. Linford', with a long horizontal flourish extending to the right.

Denis Linford
Corporate Policy and Regulation Director

Attachment

Major Policy Reviews and Self Governance - Initial Proposals

EDF Energy's detailed responses to questions

Chapter 2

Question 1. Do you agree with our assessment of the deficiencies of the codes governance arrangements and do you agree that there is a case for reform? Are the proposed reforms a proportionate response to the problems with the status quo that we have identified?

We agree that there is a requirement for improvements to take place across all Codes to improve how Modifications are managed. The Codes have all evolved at different rates and to differing levels of complexity in relation to their administration. We agree that some of the proposed reforms are a proportionate response to the problems with the status quo described in the consultation. A large volume of Modification Proposals currently issued to the Authority for decision are technical and non-strategic in nature and have no direct impact on consumers. It therefore makes sense for Code Panels to make the implementation decisions.

The MPR process as currently drafted is a disproportionate response to the widely recognised deficiencies set out in the Code Governance Review proposals. This is mainly due to the lack of robust checks and balances that we consider to be essential in order for there to be a robust counterbalance. Without additional checks and balances, enhanced abilities to appeal, confirmation that the Authority will adequately assess Ofgem sponsored modifications and additional clarity on the process for MPRs we are unable at this stage to support these proposals.

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

An appropriately developed, transparent and controlled MPR process should enable key strategic issues to be progressed more effectively. However, the existing deficiencies in the code governance process do not justify the potentially significant increase in powers that will be provided to Ofgem through the proposals as drafted. The possibility of Ofgem becoming the instigator, developer, draftsman and ultimate decision maker on code modifications does not meet best regulatory practice and introduces significant additional regulatory risk to market participants. Furthermore, as drafted there are insufficient appropriate checks and balances built into the process in order to reduce this regulatory risk. The ability of a party to challenge a decision on a code modification proposal that is simply complying with earlier legally binding review conclusions via the existing appeals mechanism is uncertain. Comparison has been made by Ofgem to the licence modification process whereby Ofgem undertakes a similar instigator through to decision maker role. However, we consider that the collective licence modification process with blocking thresholds is a much more effective, timely and less costly route to challenge regulatory decisions than the Competition Commission appeals route.

If an MPR process is to become part of the regulatory tool kit which Ofgem have at their disposal the following amendments are a high level overview of some of the changes which must be made to ensure there are appropriate safeguards and check and balances in the process:

1. Potential Major Policy Review topics should be discussed with the industry in advance of their inclusion within Ofgem’s Corporate Strategy and any other Ofgem Corporate Communications. This would provide the opportunity for robust challenge and discussion in a collaborative environment either at Code Panel Meetings, Powering the Energy Debate stakeholder sessions or smaller stakeholder group meetings.
2. Effective and transparent communication mechanisms need to be established between Ofgem, the Government and industry that are visible to market participants. If an MPR is being proposed as an answer to a Government Policy objective – that objective must be publicised in advance of an MPR being triggered
3. A legal right of challenge should be established for market participants to any direction issued by Ofgem following the conclusion of an MPR– this could take the form of a mirroring of the Collective Licence Modification process.
4. A clear governance process that Ofgem will follow when instigating and undertaking an MPR needs to be developed and published. This process should be appropriately drafted to provide assurance to the industry that regular sense checks are undertaken to ensure an MPR is still required. In addition, Ofgem should consult on any proposal to instigate an MPR prior to make any formal decision.
5. If an MPR is to be developed through industry meetings we propose there should be an independent chair. An important question here is which is the appropriate body to appoint this chair – is it Ofgem, DECC or someone else?
6. Ofgem needs to be clear how Licence holders will meet their requirement to raise modification proposals. We do not believe it should be through the raising of a fully developed modification proposal ready for consultation, rather that a modification proposal will be raised which will then progress through the assessment and development processes that are present in all of the codes.

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

Yes for certain industry codes the majority of modification proposals raised that have very little or no competition or consumer impact could be progressed via a self governance route which would significantly speed up implementation of change identified as necessary by market participants. However, it is debateable whether an accurate assessment of any possible competition/consumer issues can be made at the very outset of a modification proposal i.e. when the filtering decision is required to be made. It is advisable that the Code Panel should be able to reroute a modification if parties believe there are consumer or competition matters which need to be addressed during the assessment of the modification.

Question 4. If both the Major Policy Review and Self Governance routes were implemented, is there a case for retaining an improved Status Quo path?

Yes there is a clear case for retaining an improved Status Quo path as the complex and potentially divisive nature of some Modification Proposals requires the additional benefits that Authority consent can deliver. The existing code modification process is more than capable of appropriately handling such modification proposals in an efficient and effective manner that delivers benefits to consumers.

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

The package of reforms should be applied to all codes to ensure that market participants and consumers reap the rewards of increased efficiency and reduced cost. It would be advisable to phase the implementation of these reforms to Codes to ensure that the change in Panel structures are supported by improved governance and change control processes. Where practicable code administrators should work together to ensure that the principles of self governance can be applied in a coordinated manner.

Chapter Three: 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?

The relevant panel should take the filtering decision and it would be best practice to encourage proposer's to identify their preferred route on the Modification Proposal template. We support in principle Ofgem having the ability to veto the decision made as long as this is constrained to the assessment period and must satisfy a predefined set of criteria in advance of being deployed.

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

We support the criteria set out within the proposals document. Once the self governance proposals have bedded in we would recommend holding a post implementation review with market participants to determine the success or otherwise of the new processes.

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

We support in principle Ofgem's ability to redirect modifications subject to a pre defined set of criteria having been satisfied. These criteria should be agreed with the industry in advance of the MPR process being initiated.

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 non urgent modifications to existing arrangements that are the subject of an MPR should be subsumed within the MPR?

We are unclear as to why the modification would have to be "urgent", it would be pragmatic for parties to be able to propose modifications which can then be included within the scope of the MPR.

Chapter Four: Proposed “Major Policy Review” Process

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

While we recognise the attractive nature of the concept of flexibility within the MPR process for Ofgem, we are concerned that this increases the regulatory risk for industry participants. Should the MPR process be implemented there must be an effective control framework around it which both restricts the activities Ofgem can undertake and ensures that predefined guidelines are followed by Ofgem including the undertaking of full and proper industry consultation and regulatory impact assessment.

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

It is not acceptable for Ofgem to reserve the right to impose on the industry a fully drafted code modification change as set out in option 3. There remain legal questions to be answered on how MPR outcomes should be implemented. Ofgem will be in effect Judge, Jury and Executioner as Code Panels are unlikely to challenge an Ofgem sponsored modification. Ofgem have stated that parties would still be able to appeal outcomes to the Competition Commission however this is a heavy handed and costly route to take. Option 3 is such a new and radical change to the current regulatory arrangements that it warrants additional and robust checks and balances (see Q4 below).

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 a specified time period?

No. As highlighted above, it is not acceptable for Ofgem to reserve the right to impose on the industry a fully drafted code modification change as set out in option 3. An expedient approach to take would be to place an obligation on the appropriate Licence Holder to draft the modification required to implement the outcome of an MPR and for this then to follow the standard code modification process. However, we do have concerns that this could have a tying effect on Code Panels as if a Licence holder has been mandated to raise a modification it would be challenging for parties to vote against it.

We would note that the ability and success of parties raising a modification proposal will depend greatly on the clarity and detail provided in the MPR outcome. In particular we would note that the industry has had to undertake significant work and resources to develop proposals as it was not clear what Ofgem’s agenda and requirements were. In addition we would expect that any modification proposal raised – either by the industry or Ofgem – should be required to follow the standard assessment and development process that is present within the codes. This will ensure that a sufficiently detailed and robust proposal, along with any alternatives is available to the Authority when making a decision.

If Ofgem decide despite significant industry opposition to provide themselves with limited “backstop” powers to draft a modification this would have to be against a set of strictly defined criteria over and above the information contained within the proposals document. It is essential that any Ofgem drafted modification proceeds through the standard industry assessment and development process as it is highly likely that the

Authority would recommend implementation of any Ofgem proposals. Again this raises the issue of the difficulty of a regulatory body drafting changes to contracts they are not a party to and whether or not that approach is consistent with the Better Regulation principles.

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

See our response above to Question 2 in Chapter 2 for our general suggestions on the appropriate governance framework we consider would be necessary to provide adequate safeguards. For example, we would advocate that any Ofgem instigated workgroups should be independently chaired – in line with Ofgem’s recommendations for Code Administration. As stated there, significant enhancements in regulatory accountability are required if any of the Major Policy Review paths are to be implemented. There cannot simply be a reliance on the ability of parties to launch an appeal to the Competition Commission as the expense and resource constraints associated with such an action are beyond those available to the majority of market participants.

However, on the specific suggestion that Ofgem might, despite strong industry opposition, implement a power to impose its own worked up ‘solution’ in certain circumstances, then this is such a new and radical change to the current regulatory arrangements that **it warrants additional and robust checks and balances including the introduction of new rights of challenge**. For example, code parties should be able to formally object (with associated blocking thresholds) to any direction issued by Ofgem following the completion of an MPR similar to that used in the collective licence modification process.

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?

EDF Energy recognises the value of applying a time boundary for allowing alternative modification proposals to be raised that are pertinent to the subject of an MPR. EDF Energy believes that this is an important process so as to ensure that any issues that are identified post MPR are addressed and rectified. In particular, we would note that following a fundamental reform of regulations enhancements may need to be made which have are significant industry impacts but which were not originally considered as part of the original proposal. We would recommend that the industry and Ofgem agree a time limited period per Industry Code.

We do not support the creation of a new power for Ofgem to “turn down” modification proposals if they are not sufficiently developed. It would be more appropriate for Ofgem to utilise their proposed new power of “call in and send back” to ensure that any perceived deficiencies within the Modification Proposals can be rectified by the proposer/modification group etc

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

We agree that it would be pragmatic for Ofgem to be able to revise its MPR conclusions should pertinent information come to light. Without this ability there is a risk of inappropriate modifications to industry agreements being enforced. It would be beneficial for Ofgem to provide additional information as to how this process could operate.

Chapter Five: 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?

A more pragmatic approach would be for Ofgem to produce a straw man for each code with supporting principles that could then be developed either at the Code Administrator Working Group or a sub group thereof.

Question 2. Do you agree that there should be general appeal rights equally applicable to all code participants? Do you agree with the proposed appeal grounds?

We support the principle of general appeal rights available to all code participants and the proposed appeal grounds.

Question 3 . 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?

We support the proposal for Ofgem to hear appeals of self governance modification decisions. We agree that appeals should be made to Ofgem within set time periods and that Ofgem should have the right to refuse to hear vexatious appeals. We do not support the creation of interim fora as experience of such fora under the MRA and SPAA indicates that the outcome of a forum is the same as the outcome of a vote/recommendation made by industry. The creation of fora to hear such appeals is an unnecessary additional step in the process.

**EDF Energy
September 2009**