

ESB International Investments Ltd

UK Office

3rd Floor, Regent's Place, 338 Euston Road, London NW1 3BT, England
Telephone +44-0-207-544 8631 Fax +44-0-207-544 8401
www.esbi.ie

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

18 September 2009

Dear Andy,

Code Governance Review

ESB International (ESBI) welcomes the opportunity to respond to Ofgem's initial proposals on the "role of code administrators and small participants/consumer initiatives" and the use of "major policy reviews and self governance".

This response provides an overview of ESBI's UK activities; outlines the importance of effective governance arrangements to ESBI and provides both high-level and more detailed comments on Ofgem's initial proposals.

ESB International (ESBI)

ESBI has been a developer in the GB generation market since the early 1990's. We currently have interests in the 350MW Corby power station, in the 850MW development at Marchwood due for commissioning shortly and have recently announced our latest 850MW development at Carrington, which will commission in 2013. We also currently have a number of live transmission connection applications and offers for Combined Cycle Gas Turbine (CCGT) sites at various locations across GB.

In addition to expanding our conventional generation portfolio, we are also seeking to expand our GB portfolio of renewable generation sites. All these developments are set within the context of a €22billion package announced by the ESB Group to facilitate the transition to a low carbon economy and to make the company carbon neutral by 2020.

High-level comments

The effectiveness of the industry codes (and the way in which decisions about changes to the regulatory framework are dealt with more generally) is a critical issue for ESBI. It has a direct bearing on the risk of investing in the UK market, requires significant resource to manage and, if governance arrangements are ineffective, can distort competition and increase costs to customers (as we're finding with transmission access issues). As such, ESBI welcomes the ongoing code governance review.

We consider that it may be useful to set out what we would, in an ideal world, like to see from a system of code governance. While we recognise that there are considerable challenges associated with designing a system of governance which is fit for purpose and works effectively for all market participants, we consider that it is important to keep these high-level principles in mind when considering detailed policy proposals:

- *A relatively stable framework* – We know that regulatory and policy frameworks change and that there are issues which have to be addressed. However, stability and predictability are highly desirable components of a regulatory regime and should be facilitated via governance arrangements to the extent practicable.
- *Clear and unambiguous processes* – We favour clear, transparent and non-discriminatory processes for amending governance arrangements. This should include clearly defined remits for each party, the facilitation of participation by a range of market participants and entail a level of input proportionate to the scale of the issue being addressed.
- *A pro-active regulator* – It is, in our view, important that any system is managed by a pro-active regulator who understands the views of a range of market participants and takes clear and transparent actions to address issues.
- *Checks and balances* – Views between market participants will always differ and there will inevitably be support for, and opposition to, any proposed change. Frameworks must foster full consideration and healthy debate of these issues as well as providing sufficient checks and balances which allow challenge where this may not be considered to be the case.
- *A balance between timeliness and rigour* – Where there is a case for change, that change should happen relatively quickly. While an opportunity for parties to engage and provide opinions is vital, a balance needs to be struck and consultation for its own sake should be avoided.

Ofgem's Code Governance Review appears to have considered types of generator at two ends of a spectrum – with large incumbents at one extreme and smaller renewable/ distributed generation at the other – and considered the issues which each category faces. ESBI does not fit comfortably into either of these categories and, as such, we are concerned that the issues that ESBI, and other parties in a similar position, face have not been fully considered and explored as part of the smaller participants review.

Although we have relatively modest assets in GB, we are primarily a new entrant developer seeking to increase our portfolio of conventional and renewable generation. We consider that new entrants such as ESBI have a particularly important role to play in promoting generation market competition and ensuring medium-term security of supply. Therefore, while we face many issues which are common to smaller generators, we consider that it is important that Ofgem ensures that a range of positions are reflected as its proposals develop.

While we welcome Ofgem's consideration of these issues, we are not convinced that Ofgem has explored the full suite of available options or demonstrated that its proposals would provide demonstrable benefits to market participants and ultimately consumers. In particular, we note that:

- The major policy review proposals provide Ofgem with significant additional powers and considerable discretion. We do not consider that points about

accountability have been appropriately addressed and are concerned that there is insufficient clarity to allow us to conclude that the proposals reduce regulatory risk.

- It is not clear that the net result of the suite of proposals would be to reduce the commitment required of market participants, increase accessibility or enhance the speed or credibility of decision making.

More detailed comments are provided below.

Major policy reviews & self governance

In this section we set out more detailed views on the issues raised by Ofgem's initial proposals for major policy reviews and self governance. In ESBI's opinion, Ofgem has bundled together two issues which we consider to be separate. Whether or not some or all proposals should be subject to a more streamlined process is unrelated to whether Ofgem should be able to pro-actively implement major policy reviews. We therefore address each issue separately.

Major Policy Reviews

Major policy reviews represent a relatively fundamental shift in the operation of the industry code processes. They provide powers which the Authority does not currently have (at least formally) to investigate issues, mandate change and then make the final decision in respect of that change.

We are concerned that the statutory role of Ofgem is being blurred by the proposals it is presenting. Currently, the development of energy policy is a privilege of the elected Government and its officials. The proposals within this consultation appear to grant Ofgem powers of policy development and implementation but without the checks and balances provide the robust challenge of Parliamentary due process. Our concerns arise as it is difficult to see where such challenge would be provided and how Ofgem's statutory role of independent economic regulator would be maintained within such a regime.

While we do not disagree that there may be occasions when these powers could be effective and useful, we do consider that they currently lack transparency and have the potential to circumvent the checks and balances of an effective code governance system. If poorly designed or implemented they could lead to unanticipated regulatory framework changes, increase the frequency of change and significantly increase risk.

ESBI would therefore be more comfortable were additional checks and balances built into the MPR proposals. For example, we would recommend the following:

- Any party should have the ability to refer a modification proposal which Ofgem has proposed via a MPR to the Competition Commission (rather than it being based dependent on the way the CUSC Panel votes). This would ensure that, if required, a proposal could be considered by an independent party.
- Ofgem should explicitly commit to not implementing more than 2 MPR's per year, which would provide some comfort over the degree of resource required to interface effectively with the MPR process. Further it should provide early warning of possible forthcoming MPR's in its corporate plans to ensure Authority sign-off of policy direction whilst providing industry participants early indications of resource requirements.
- Given the likely materiality of the issues at stake, Ofgem should commit to ensuring 2 month consultation periods for all MPR related documents, ensuring that participants can submit well reasoned and considered responses.

Self Governance

We consider that it is necessary to consider whether the existing processes for dealing with relatively inconsequential or “house-keeping” modifications are deficient before considering issues around self governance. In our experience, the industry code process tends to cope well with minor (or indeed as acknowledged by the consultation document incremental) change. Proposals, which by their nature tend not to be time critical, proceed through the various panels and tend to result in timely decisions by Ofgem; which we assume involve relatively little resource. The process is well understood and routes of appeal are clearly defined. Perhaps most importantly, there is no need to make an ex-ante definition of materiality (which we accept can be problematic)¹. Given these factors, ESBI struggles to see a compelling case for moving away from this approach.

We consider that it would be useful if Ofgem could provide an ex-ante assessment of the effectiveness of self governance within all the relevant codes, taking account of the views of market participants, to help inform our consideration of the proposals.

The role of code administrators and small participant/consumer initiatives

ESBI considers that this is an area where there is considerable scope to improve effectiveness and, as such, we are pleased to provide comments.

The role of code administrators

ESBI is particularly supportive of increased clarity over the role of code administrators and support greater transparency and accountability in their actions. We therefore support the initiatives which ensure that a full range of viewpoints are discussed, including the appointment of independent chairpersons, and the publication of detailed minutes.

As well as independent chairs, we consider that it may be appropriate to consider the composition of Panels. We consider that it is important that Panels include a representative sample of market participants such that a full range of views is heard (noting that Panel members are required to act independently). To do otherwise runs the risk of undermining the voting process and skewing the assessment of proposals. While we would stop short of proposing quotas for Panel membership, we do consider that ensuring a representative sample (and making some provisions where parties may be relatively less able to engage in the decision making process) would be highly beneficial.

Small participant/ consumer initiatives

The purpose of this workstream is to facilitate market participation by smaller participants and customer representatives. At the heart of this issue is the question of what resources a market participant should be required to commit to understanding the regulatory framework? ESBI considers that it is appropriate that parties invest some resource in understanding the regulatory framework (and that policy should be developed in light of an expectation of participation) but that the framework needs to be proportionate and not skewed in favour of larger players (which may have adverse consequences for competition and/or market liquidity). ESBI is therefore supportive of proposals which facilitate inclusion or ensure a more proportionate regulatory burden.

In particular, we would support the following:

¹ Other than for a code administrator to determine whether a Working Group should be formed.

- *Fewer consultations (at working group level and by Ofgem in undertaking impact assessments etc) and longer response periods.* ESBI, and no doubt other small and medium industry participants, occasionally struggle to respond to the sheer volume of consultations. This can compromise the quality of response and we are not sure that the marginal benefit of additional rounds of consultation is always justified.
- *A more holistic consideration of issues* – A significant frustration of the industry code processes is the fragmentation caused by the inability to discuss issues pertaining to different codes in a similar forum. To the extent practicable, we would support moves to allow similar issues to be considered together and a more coordinated approach to planning meetings and consultations.
- *Ofgem to provide more information in coordinating industry codes* – Ofgem is in a unique position given it has a division which is expressly charged with overseeing the operation of the industry codes. In our view, that division would be well placed to disseminate information about codes at a relatively small additional cost. For example, it would be relatively simple to expand the decision making timetables which Ofgem periodically circulates to include descriptions of modification proposals and indicative decision timescales (we note that this is available from some consultancies, but at a cost). This would allow greater cross code co-ordination and assist participants in planning responses.
- *Public modifications database* - We understand Ofgem has a modifications database which informs its internal decision making. We consider that, were the database to be adapted and made more public, it could prove a useful tool for keeping track of proposals and submitting views. For example, were each company to have a login, it would be possible for them to read summaries of proposals (which Ofgem already produces) and could contribute their views relatively easily. This would allow other parties' views to be understood, inform views on materiality and enhance Ofgem's own decision making processes.

We hope that the comments and suggestions included in this response prove useful. We look forward to understanding Ofgem's final proposals and, we hope, participating in a more effective and proportionate system of governance in the future.

Should you wish to discuss this response further please do not hesitate to contact me.

Yours sincerely,

Michael Dodd,
GB Regulation Manager

By e-mail