



First Hydro Company is part of a joint venture between
International Power plc and Mitsui & Co., Ltd.

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

18th September 2009

Dear Andy

Code Governance Review: Major Policy Reviews & Self Governance Initial Proposals

I am writing to you on behalf of International Power's UK generation assets (Deeside Power Development Co Ltd, First Hydro Company, Rugeley Power Ltd, Saltend Cogeneration Co Ltd, and Indian Queens Power Ltd). International Power welcomes the opportunity to comment on Ofgem's code governance proposals, having been actively engaged in the code change processes for the CUSC and BSC since their inception, and to a lesser extent the UNC.

We have provided responses to the questions within the consultation below however we would like to stress the key points of our response:

- We agree that a process which would allow a holistic approach to cross-Code issues would be a good idea, however we cannot lend our support to the MPR process because of concerns we have about giving Ofgem the ability to mandate binding direction on industry to raise code changes (or for Ofgem to raise them itself). The recent transmission access review provides a good illustration of the potential pitfalls of extending Ofgem's powers in this way. Had the transmission access review been conducted via the MPR process, it is conceivable that the 'connect and manage' options preferred by the Government might no longer be under consideration.
- It is important that any extension of Ofgem's powers should be accompanied by strengthened checks and balances. We do not think an appropriate balance has yet been proposed.
- The MPR process being proposed is not sufficiently defined, possibly because Ofgem wishes to retain flexibility. We think it is important that clear and transparent procedural rules, timelines and decision criteria are developed and consulted upon. Without this important detail it is not possible to assess whether the MPR route would be more or less effective and efficient than the current arrangements.
- We support a degree of self governance with appropriate routes to appeal, but do not agree that this should only be introduced as part of a package.

First Hydro Company
Bala House
Lakeside Business Village
St David's Park
Deeside
Flintshire
CH5 3XJ

Tel + 44 (0)1244 504 600
Fax + 44 (0)1244 504 613
www.ipplc.com
www.mitsui.co.jp

First Hydro Company
Registered in England: 02444277
Registered Office: Senator House
85 Queen Victoria Street
London EC4V 4DP

I hope you find our comments helpful.

Yours sincerely

Emma Williams
Market Development

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 are not persuaded by Ofgem's assessment of the deficiencies of current arrangements and question whether it is appropriate to draw broad conclusions on the basis of reform in just two areas - cash-out and transmission access. The consultation cites multiple proposals, duplication in assessment, piecemeal development of proposals and lack of industry consensus as reasons for delays and difficulties. We believe it is an important aspect of the current arrangements that there is the facility to raise alternative modifications, even if this might lead on occasion to additional assessment costs.

The consultation document suggests that reform of cash-out arrangements has suffered by having occurred in a piecemeal fashion, we believe this is a reflection of the fact that there are divergent views held across industry as well the evolution over time in industry and the regulator's thinking on cash-out arrangements, not an indictment of current code governance arrangements. Finally, we do not agree that divergence in industry opinion on key areas of reform can be viewed as an obstacle to timely and appropriate reform; it is inevitable that market participants will hold divergent opinions and important that every party, large or small, enjoys the right of having their opinion heard.

In addition to our doubts that there is indeed a case for reform, we are also concerned that the MPR process as proposed would represent a significant increase in regulatory control without a corresponding increase in the existing checks and balances. We do not therefore agree that the proposals represent a proportionate response.

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

It is not clear whether this would be the case because the initial proposals do not provide enough detail of the actual process for an MPR, in particular with regards to timescales. For issues with cross Code implications, a holistic approach would intuitively seem a sensible means of progressing change however any change process must be properly defined, with clear timelines.

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

Yes. There are clearly efficiencies to be made by introducing a degree of self governance. This route, for straightforward changes, would avoid duplication of work, allowing Ofgem to focus their resources on the more significant issues.

Ofgem's proposals for self governance now include recourse to CC appeal, following appeal to Ofgem. We consider this a significant improvement to the self governance process being proposed.

We do not agree that the self governance route should only be introduced as a part of a package; if the benefits of introducing a degree of self governance are clear and receive widespread support, we think there is merit in adopting the self governance proposals with or without the MPR.

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

Yes. Were both routes to be implemented, it might be appropriate in time to lose the status quo path however, this would only be the case when there was considerable experience and complete confidence in the new arrangements. Realistically, we believe most changes would continue to be progressed via the 'status quo' path.

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?*

We agree that the relevant panel is best placed to make the initial filtering decision, being most familiar with the detailed provisions of each Code. We also think it would be useful for the originator of a modification to indicate which path they consider appropriate.

Given unambiguous filtering criteria, supplemented by supporting guidance drawn up by Ofgem, we would not expect many instances where an Ofgem veto would be necessary. However, there might occasionally be a need to redirect a proposal during its assessment where, for instance, issues arise during industry evaluation, though we have some concerns about the increased regulatory uncertainty such a power would bring. If introduced, the veto's use must be strictly bounded and always be accompanied by a full explanation. Furthermore, we think it is important that there is a clear process for industry participants to request redirection or challenge the initial decision and would welcome more clarity from Ofgem on this.

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 proposed criteria appear reasonable. The difficulty with any such criteria is that there is always some room for interpretation; on the other hand, if the criteria are really 'nailed down' there may not be sufficient flexibility to allow the exercise of sensible discretion. We suggest that Ofgem issues and consults on specific guidance on the filtering criteria and their application.

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

See comments above

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?*

Given the criteria against which any request for urgency is judged we believe it is essential that such requests can be made to Ofgem at any time, whether or not the modification is potentially linked to an ongoing MPR.

In principal, we are opposed to any kind of moratorium because the right for any code party to propose a change is fundamental to the current governance arrangements. We can however appreciate Ofgem's view that this might detract from the very purpose of the MPR. We are uncomfortable with the imposition of a moratorium on modifications during an MPR without considerably more detail on exactly what formal consideration a 'subsumed' modification proposal

would receive during the MPR and how it would be dealt with as part of the MPR conclusions. We would therefore welcome more detail in this area to allow informed industry consideration.

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 our response to the previous MPR consultation we highlighted our concern about the lack of detail provided by Ofgem on the MPR process. The current consultation has gone some way to providing this, but not nearly far enough.

We welcome Ofgem's proposals to signpost, where possible, forthcoming MPRs in the publication of the Corporate Strategy, as well as the intention to set out a timetable at the outset of an MPR and consult thoroughly during the MPR process. We would, given the nature of any issue being considered by an MPR, naturally expect Ofgem to conduct an impact assessment prior to issuing any directions. However, we still retain reservations regarding the lack of detail being proposed by Ofgem for the MPR process; with no firm view of the MPR procedure it is difficult to judge if it represents efficient decision-making. We can understand Ofgem's preference for a flexible process but are concerned that this flexibility might increase regulatory uncertainty for industry. If the MPR process is in fact workable there should be scope to clearly define a generic MPR process whilst retaining sufficient flexibility and hope Ofgem will address this in the development of any further proposals.

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

Ofgem propose to publish 'principles' at the outcome of an MPR which should inform any modifications, possibly accompanied by an actual outline of desired modifications. In our response to the previous MPR consultation we noted our concerns that it is not always a straightforward process to move from principles to the detail necessary to codify a change. Sometimes it is only when a proposal is fleshed out, when the detail is being developed, that its practicability can be determined; for example, NG's initial proposal within the TAR for transmission access on a zonal basis, which was only shown to be unworkable following three months of intensive and detailed work by the industry workgroup. We continue to hold these concerns.

In addition, we note that Ofgem is proposing a 'backstop' power to draft code modifications. We question whether this would be a workable arrangement inasmuch as this would lead Ofgem to a position of making decisions on proposals it had raised itself and there must also be some question as to whether there is appropriate expertise within Ofgem to undertake this role.

Question 3: *Do you agree 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?*

We would like more clarification on this question because it is not sufficiently clear how Ofgem proposes to pass the responsibility of raising MPR related code modifications to industry. Our original understanding was that Ofgem intended to rely on Grid alone however Ofgem's recent presentation to the BSC Panel on the code governance proposals suggests that there is also an intention to amend Generator, Shipper & Supply licences. It is very important there is no ambiguity in proposals in this area. We would welcome a clear outline of Ofgem's intentions accompanied by draft texts of any proposed licence amendments.

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

Some of our concerns regarding the efficacy of existing rights to appeal to the Competition Commission have been addressed in the consultation. In particular we welcome the comments made by the Competition Commission which Ofgem report, namely that an appeal could cover the MPR conclusions and not just the subsequent modification, and that no code participants' right to appeal would be curtailed by the process, as had been feared. Given the importance of these comments we think it would be very useful if a fuller statement could be published confirming the responses given by the Competition Commission.

However, we are not yet persuaded that the proposals for safeguards and appeal mechanisms put forward by Ofgem provide sufficient balance. The 'checks and balances' of the modification process do not only refer to the fact that industry enjoys certain rights to appeal against Ofgem decisions. The process of appeal is not efficient, being expensive and long and arguably less accessible to smaller participants due to their lack of resource/relevant knowledge. To a great extent the safeguard within the modification process derives from the arrangement whereby Ofgem acts as arbiter, industry as initiator. In extending Ofgem's role to initiator as well as arbiter the structural safeguard inherent in the code modification process is lost. It is clear that the authors of the Brattle Critique agreed that an extension of Ofgem's powers, such as being proposed for the MPR process, must be accompanied by strengthened checks and balances:

"However, it is also clear that any extension of Ofgem's powers should be accompanied by strengthened checks and balances. As background, we note that the safeguards now in place are already much stronger than they were when the current arrangements were put in place, owing to the introduction of appeals, the requirement for Impact Assessments, and arguably the increasing prominence of judicial review. Nonetheless, in our view any reform along the lines we suggest would necessarily include additional safeguards in the form of (a) clear and transparent procedural rules and decision criteria, and (b) a right of appeal to the Competition Commission."¹

We would therefore urge more consideration of the issue of safeguards and appeals mechanisms for the MPR process. We would also note that the appeals mechanisms being proposed would only allow for appeal at the very end of the process. If an industry participant believes there is a fundamental issue with the MPR conclusions reached by Ofgem and that this could constitute a legitimate appeal it is inefficient to prevent them appealing until after modification proposals have been worked up and decided upon.

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

We agree that it is important that industry participants have the opportunity to develop and raise alternative modifications following an MPR however, we do not believe that the two month window being proposed is adequate. Two months would not necessarily allow industry sufficient time to

¹ Critique of the Industry Codes Governance Arrangements, pg 93 – see also pg 7, "Because Ofgem would lead the process, there would have to be a strong right of appeal, e.g. to the Competition Commission. Some legal issues would need resolving here, since currently an appeal is possible only when Ofgem has overruled the Panel"

develop and work up viable alternatives. The consultation proposes that the clock would start ticking from the point Ofgem MPR conclusions/directions were published. We propose that if such a window is to be introduced, it should be linked to the date the initial modification proposal is raised, and should be longer than the two months being proposed.

In principle however we are uneasy about lending support to any kind of moratorium on the ability to raise modification proposals as this might prevent the most efficient solution to a defect being identified and adopted. It is also worth noting that there can be lengthy lead times in the implementation of some modifications during which time industry would have no recourse to propose potentially beneficial changes.

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

We can envisage situations where significant issues arise following the publication of the MPR conclusions but we are also concerned that this facility would add to regulatory uncertainty. In order to provide industry with more regulatory stability, this right would clearly need to be appropriately constrained. It is not clear from the consultation up to what point in time Ofgem are proposing to retain this right, or if any specific criteria would need to be met. There should also be more detail on the process Ofgem envisages following any revision of 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?*

Yes. This is preferable to the establishment of one structure for self governance to be implemented across the different codes.

Question 2: *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 important that all code participants have equal rights to appeal a self governance decision. With regards to the grounds for appeal being proposed, we agree some criteria are necessary but care must be taken to ensure they would not overly constrain a party's ability to appeal.

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?*

Yes, Ofgem would seem the obvious choice to hear appeals of self governance decisions. With regards to the intermediary forums being proposed to assess whether an appeal should proceed to Ofgem, we question whether such forums would be sufficiently independent of the original decision making body and do not think there is sufficient justification for their introduction. Given the straightforward nature of modifications following the self governance route and the facility for re-

direction, we imagine appeals will be rare. We would therefore support a general right of appeal directly to Ofgem without the establishment of an assessment forum.