

MAJOR POLICY REVIEWS AND SELF GOVERNANCE**SCOTTISHPOWER RESPONSE TO QUESTIONS****Chapter 2: Key issues and objectives****Question 1: Do you agree with our assessment of the deficiencies of the codes governance arrangements and do you agree that there is a case for reform? Are the proposed reforms a proportionate response to the problems with the *status quo* that we have identified?**

While we understand Ofgem's concern that some issues have not progressed as rapidly through the code governance as it would like, this is not necessarily indicative of a major failure of the system. While Ofgem has characterised the issue as one of "tackling head-on the scope for vested interests to delay key rule changes"¹, we suggest that this may not be the entire picture. From the industry side, the problem has been that Ofgem sometimes has a view on the ideal solution which does not garner support from other stakeholders. If this leads to an unwillingness to consider alternatives, the result can involve delay. In many cases, when the issue has been put before an independent party for a decision, that party has backed the industry view.

For example, it appears that DECC is minded to favour a hybrid connect and manage solution to the reform of transmission access. We judge that the Transmission Access Review could have reached a successful conclusion along such lines, in reasonable time, if Ofgem had been prepared to endorse such a solution.

The existing code governance mechanisms have worked well during the period of intensive change to refine and adapt the mechanisms introduced on the introduction of the NETA and then BETTA arrangements. We think that incremental change may be more effective than root and branch reform. Moreover, the current proposals for the Major Policy Reviews (MPRs) seem in our view to be somewhat complex and potentially unwieldy; they could prevent the prompt identification of the optimal solution.

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

There is a case for streamlining the existing mechanisms to ensure that change which over-arches multiple codes and charging mechanisms can be considered in a holistic fashion but ultimately change should undergo rigorous scrutiny by those who will have to implement it and operate their businesses under it.

We would like to see the MPR process refined so that it achieves this objective.

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

We agree that a self-governance approach would be appropriate for a significant proportion of modification proposals provided adequate safeguards are provided to ensure that issues which may affect competition are referred to the Authority for

¹ Lord Mogg, 28 July 2009, letter launching Ofgem 5 year strategy consultation.

approval. The industry codes which already successfully provide for self-governance should be used as a template for its wider introduction.

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

We do not think that the proposed MPR process should operate as a separate path from the, hopefully improved, *status quo* path. Instead, we see it more as a wrapper which Ofgem could use to bring a degree of coherence to cross cutting or complex proposals. It follows that we think the status quo path needs to be retained.

Within Ofgem's proposed framework, it is not sufficiently clear when a proposal may have a "non-trivial" (path 2) but "non-significant" (otherwise path 1) impact on consumers or competition. We think that more clarity is required on the criteria proposed for MPR reviews, given the comment that back-casting suggests only 1-2 MPRs per year.

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

As in our response to question 4, the application of a single regulatory governance regime across all codes would achieve the aim of simplicity thus making the process more accessible to market participants less able to devote resources to participating in multiple processes. However, it is not clear if it is appropriate to include technical codes such as the Grid Code in this review.

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?

In our view, of the MPR being a wrapper to help guide complex or interlinked modifications, it should not be necessary for Ofgem or the code panel to divert any modification into an MPR path. Indeed, diverting all significant modifications into an Ofgem-led MPR path could have the perverse effect of slowing progress in the event that Ofgem was not proactively considering an MPR in the area concerned.

We agree that the filtering process for self-governance should be undertaken by the relevant industry code panel, utilising a set of clear criteria. It is reasonable for Ofgem to have a right to switch self-governance proposals to the normal governance.

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?

On our view that MPRs should be a wrapper rather than a separate process, we would question the need for a separate path 1.

If such a separate path were to be found necessary, the filtering criteria between Paths 1 and 2 are broadly appropriate. However, there is a risk that too many modifications would end up in path 1, leaving a considerable backlog of MPRs to be undertaken. For this reason, the first test of “significant impacts on competition or on gas and electricity consumers” should include further guidance on what would constitute a “significant impact” to avoid too many modifications triggering an MPR. This would remove uncertainty from the modification process as to whether the MPR mechanism would be used.

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

We agree that the filtering criteria between Paths 2 and 3 are appropriate. As with our response to question 2 above, guidance should be provided on what constitutes a “non-trivial impact” under the tests proposed.

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?

We agree that a party should be able to raise an urgent modification proposal to arrangements that are the subject of an MPR. This will allow market participants to respond to issues which arise during the MPR process and contribute to the development of efficient solutions.

We do not think that the raising of alternative or supplementary modifications should be subject to Ofgem approval. Stifling of consideration of alternatives will not in our view speed up the process in the long run, but will risk increased numbers of appeals to the Competition Commission.

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?

Provided that greater clarity is provided on the criteria for subjecting a modification to the MPR process, we agree that the MPR process should be proportionate to the nature of the issues being addressed, being neither overly bureaucratic for simple issues, nor providing inadequate debate and consultation on complex issues. The proposed MPR process should be outlined at its commencement and the views of participants should be taken into account in determining the process to be followed.

We think that the MPR would best be operated as a “wrapper” for co-ordinating modifications that are processed through the usual governance.

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

We believe that the outcome of the MPR should be high level policy conclusions. We have concerns about the use of a licence condition to direct licence holders to raise modifications giving effect to decisions arising from a Major Policy Review as it is not sensible or practicable to seek to force participants to raise proposals that they disagree with. It is better for Ofgem to retain ownership and responsibility for raising the code modifications to deliver those high level conclusions. In practice, it is likely that one code party or another may bring forward drafting to help Ofgem out, but this should be a voluntary activity. The modifications coming out of an MPR should not have a special status in the governance, though parties will naturally expect that Ofgem will be minded to approve them and focus their thinking accordingly.

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?

We agree that once Ofgem has raised the appropriate code modifications, industry is best placed to refine the drafting of those modifications to deliver the policy conclusions in the most pragmatic and efficient manner.

It is reasonable that Ofgem should have backstop powers to draft modifications arising from an MPR, providing that these are *pari passu* with other modifications.

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

The possibility that the Authority could be both initiating code change proposals and adjudicating upon them will inevitably lead to a certain awkwardness. It will be important in such circumstances that appeal processes, together with Ofgem’s better regulation duties of transparency and accountability, are applied with particular rigour. Ofgem are therefore right to ensure that the route of appeal to the Competition Commission will be available without any additional restrictions, should the relevant Panel not be convinced by the case.

Rights of appeal through judicial review should also be available where there are other failures, such as not carrying out a proper Regulatory Impact Assessment or, should there be powers for Ofgem to block other proposed modifications, inappropriate use of those powers.

The MPR process must embrace the principles of the government's Better Regulation Guidelines.

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 think that the MPR process should not prevent other modifications from being proposed. If Ofgem agrees with our view, an explicit time window would be unnecessary.

In any event, adequate time must be available to allow for alternative modifications to be considered. This would allow the nature of the proposed modifications together with any alternatives raised by industry and their potential impact to be clarified at an earlier date.

If there is an explicit time window, it should not be so brief as to restrict the raising of high quality modification proposals and participants should be able to seek an extension to the window if required to improve the drafting of resultant modifications. A sensible minimum duration would be about two months.

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

In our vision of the MPR process, this would be reasonable. Were Ofgem's process to be employed, we would agree that Ofgem should be able to revise its MPR conclusions but only to the extent that this results in the maintenance of the status quo. Ofgem should be subject to a time window, similar in duration to that discussed in question 5, during which it will be able to revise its conclusions. The consideration of new information, significant enough to affect the outcomes of an MPR, should be achieved through a further consultation process involving industry and not be solely at Ofgem's discretion.

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?

We agree that the industry is best placed to draw up the arrangements for self-governance processes similar in nature to those adopted in the DCUSA. Such arrangements should facilitate full consultation on the issues and allow all participants to have their views considered.

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

Provided the filtering process outlined in Chapter 3 is clearly defined, we would foresee very few circumstances where it would be necessary to redirect a modification from Path 3 to Path 2. However, should a participant become concerned at the direction in which a modification is proceeding they should be able to request that the Authority consider redirection of the modification to Path 2.

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?

We agree that there should be similar appeal rights to self-governance modifications which are available to all market participants. We do not foresee a requirement for special rights of appeal for consumer groups or small industry participants.

The proposed grounds of appeal are acceptable to us and have been shown to be appropriate in the MRA and SPAA.

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?

We agree that Ofgem is the appropriate body to hear self-governance appeals following a process involving a forum elected from code parties. The suggested time limit of ten working days for raising an appeal against a self-governance proposal is consistent with an efficient process and reducing uncertainty. We further agree that Ofgem should be able to reject frivolous, vexatious or appeals with a limited chance of success.

We do not have a strong view on whether Ofgem should be able to require parties to bear its costs of hearing an appeal in certain circumstances. However, we would observe that such provisions might act as a deterrent to appeals by smaller companies.

Appendix 2: Impact assessment

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

ScottishPower agrees that reforms along the broad lines proposed could facilitate the consideration of issues which impact across multiple industry codes and charging statements and could thus be more effective in achieving major change. However, we think the detail of the proposals is based too strongly on the thought that Ofgem's proposed solution to a problem, even if reached after consultation, is necessarily the optimum way forward. The proposals are too ready to reject alternative thinking and therefore need modification if they are to achieve their declared objectives. In their present form, they risk introducing increased complexity and leading to more appeals to the Competition Commission.

We support the extension of self-governance arrangements as outlined in the consultation to improve the efficiency of the modification process.

We believe that the existing industry code processes produce rigorous analysis and result in high quality modification reports for consideration by Ofgem. Any deficiencies in the existing process could be addressed through more active participation by Ofgem representatives in the modification process who should identify any further analysis requirements before submission of the modification report for determination.

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

ScottishPower does not agree with the quantitative assessment of the potential cost savings based upon the case study of electricity cash-out reforms. It is not clear that an MPR process would have got to the outcome in P217A in one cycle or indeed that it might not have ended up at a different destination. The assessment is therefore constructed on a speculative basis. It is also unclear whether earlier implementation would have saved consumers money through the slightly different incidence of balancing costs. The incremental changes progressed by industry have allowed examination of the impact of each change upon cash-out prices and the wholesale electricity market while allowing participants to adapt systems and procedures as appropriate. It is not therefore clear whether an MPR process would have led to significant administrative cost savings.

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

We believe that some reform of industry code governance will help to achieve the government's key objectives on climate change, security of supply, affordability for the consumer and investment in grid infrastructure. However, the proposed reforms, in their current form, may fail to improve the speed of decision taking. Furthermore, they could increase regulatory uncertainty and delay the necessary investment in GB energy infrastructure. The reforms need to be redesigned to avoid these negative effects. We believe that the proposed reform of industry code governance would have limited scope to impact upon competition.

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

We do not believe that the consultation has considered the potential detrimental impact of increased regulatory uncertainty upon the necessary investment in GB

energy infrastructure to ensure that climate change and security of supply objectives are achieved. This regulatory uncertainty would arise from the increased concentration of power at Ofgem and the corresponding weakening of market participants' influence upon change processes. This could result in attempts to impose changes that do not find support among market participants, leading to Competition Commission appeals.

Furthermore, the added complexity of the MPR system as proposed, and the lack of opportunity to consider alternatives, could make it harder to reach the optimum solution than the existing governance procedures.

ScottishPower
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