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Our Reference:
Your Reference:

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Dear Mr MacFaul,

## Code Governance Review: Major Policy Reviews and Self-Governance – Initial Proposals.

Thank you for the opportunity to comment on the package of reforms to industry code governance arrangements that are currently being proposed by Ofgem.

Given the changing regulatory environment and market, it may well be the right time to consider major reform of the existing industry code governance arrangements and, as acknowledged by Ofgem, this is one of the most important developments for both Ofgem and the industry in the coming year.

Against this background, we understand the rationale for and support the principle of an enhanced role for Ofgem to lead and co-ordinate code changes in major policy areas in a timely manner. In addition, we welcome the proposals to introduce more industry self-governance for modification proposals with minimal impact on customers or competition. However, we have two significant concerns about the proposals as they currently stand which in our view must be addressed in order to ensure that an effective, transparent and proportionate governance regime is maintained.

Generic Licence Condition

First, Ofgem propose achieving the package of reforms by introducing a generic licence condition on licensees which will enable Ofgem to "direct" a licensee to raise one or more modification proposals on Ofgem's behalf to give effect to an Ofgem decision. It is difficult to see how such an approach can be viewed as transparent or indeed effective; licence conditions compelling other parties to implement Ofgem's preferred reforms have not worked well in the past (for example, the obligation on the NTS and DNs to introduce NTS exit reform following the DN sales). We would also question whether such a licence condition would be enforceable in practice. As a consequence, we would find it extremely

difficult to accept such an open-ended, generic licence condition as is currently being proposed by Ofgem.

If, as a result of a Major Policy Review, Ofgem conclude that change is necessary then Ofgem should have the courage of its convictions and raise the necessary modification proposal(s) directly itself. That is, Ofgem should be put on an equal footing with other industry code signatories and have the ability to raise modification proposal(s) directly (Option 3).

However, this does not mean that Ofgem has to draft the relevant modification proposal and indeed the expertise for drafting the requisite legal text/detailed working of a modification proposal clearly lies within the industry, not Ofgem. We believe that under both Options 2 or 3 industry will need to be fully engaged in the detailed working up of the relevant modification proposals. The key difference between Options 2 and 3 is who raises and owns the modification proposal (i.e. a licensee directed by Ofgem or Ofgem itself, respectively), while under both options it would require to be worked up via the relevant code modification / industry processes. We believe that this must be clarified by Ofgem in order to ensure that this consultation exercise is both open and fair.

Individual Right of Appeal

Second, it is clear that a primary difference between Ofgem and other code signatories is that Ofgem also make the final decision as to whether a modification proposal is approved or rejected. Therefore, in order to preserve an appropriate balance of rights across the parties, we strongly believe that provision should be made for an individual company right of appeal on the basis of undue prejudice or material hardship. This individual right of appeal would only apply in the case of modification proposals raised by Ofgem.

Ofgem propose that there should be a right of appeal for all parties against self-governance modification decisions where it is likely to prejudice unfairly the interests of a party to the code. Such modifications will, by definition, have minimal impact on customers or competition. It would therefore seem disproportionate to have in place such a right of appeal in relation to the least significant modification decisions but to not have an equivalent right of appeal to the appropriate body available in relation to, by definition, the most significant modification decisions.

In addition, Ofgem state that under the proposed European codes arrangements, the Agency for the Cooperation of Energy Regulators (ACER) will take a more pro-active role and be able to raise modification proposals itself to the proposed cross border codes. However, this more pro-active role will be balanced with an individual party right of appeal and we firmly believe that Ofgem should support the introduction of a similar right of appeal as part of it's Major Policy Review reforms in the interests of fair and proportionate regulation.

In our view, such a right of appeal is necessary in order to comply with the requirements of the Electricity Directive which states that:

*"Member States shall ensure that suitable mechanisms exist at national level under which a party affected by a decision of a regulatory authority has a right of appeal to a body independent of the parties involved and of any government."*

It is our understanding that the Directive is to be interpreted in such a way as to give any party affected by any decision of the regulator an individual right of appeal (separate and additional to the right to a judicial review). Therefore, in our view, where an individual party is materially and unfairly affected by a decision by Ofgem to approve or reject a modification proposal on a significant policy change which has been raised (either directly or indirectly) by Ofgem, they should have recourse to a right of appeal. We do not believe that the current arrangements (which were introduced some time ago) would represent "suitable mechanisms" if Ofgem's wide-ranging Major Policy Review reforms are implemented.

We believe that it would be relatively straightforward to introduce such a right of appeal and we would therefore urge Ofgem to begin working with DECC on this issue before the proposals for reform are finalised.

We have been fully engaged in the industry code governance review process to date and we hope that we can continue to work together to resolve these issues with a view to developing a robust and fair package of reforms which is acceptable to both Ofgem and industry.

We have expanded on the above points in our answers to Ofgem's specific questions set out in the attached Appendix.

Yours sincerely

Rhona McLaren
Regulation Manager

cc: Paul McIntyre, Director, Energy Security and Markets, DECC

## Appendix 1: Specific Questions by Chapter

Chapter Two

*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 believe that in general the code governance arrangements have worked well to date and we do not share all of the concerns that have been raised by Ofgem. However, given the changing regulatory environment and market, we recognise that now may be the right time to consider major reform of the current arrangements.

In terms of whether the proposed reforms are a proportionate response to the problems with the status quo, we believe that in two specific areas they are not, namely i) Ofgem's proposal to introduce a generic licence condition on licensees to require them to raise modification proposals on Ofgem's behalf; and ii) a significant rebalancing of power in Ofgem's favour with no additional protection proposed for individual companies i.e. a specific right of appeal.

In the case of i) above, it is difficult to see how such an approach can be viewed as transparent or indeed effective; licence conditions compelling other parties to implement Ofgem's preferred reforms have not worked well in the past (for example, the obligation on the NTS and DNs to introduce NTS exit reform following the DN sales). We would also question whether such a licence condition would be enforceable in practice. As a consequence, we would find it extremely difficult to accept such an open-ended, generic licence condition as is currently being proposed by Ofgem.

If, as a result of a Major Policy Review, Ofgem conclude that change is necessary then Ofgem should have the courage of its convictions and raise the necessary modification proposal(s) directly itself. That is, Ofgem should be put on an equal footing with other industry code signatories and have the ability to raise modification proposal(s) directly (Option 3). However, this does not mean that Ofgem has to draft the relevant modification proposal and indeed the expertise for drafting the requisite legal text/detailed working of a modification proposal clearly lies within the industry, not Ofgem. We believe that under both Options 2 or 3 industry will need to be fully engaged in the detailed working up of the relevant modification proposals. The key difference between Options 2 and 3 is who raises and owns the modification proposal (i.e. a licensee directed by Ofgem or Ofgem itself, respectively), while under both options it would require to be worked up via the relevant code modification / industry processes.

In the case of ii) above, given the significant rebalancing of power being proposed by Ofgem, we strongly believe that provision should be made for an individual company right of appeal on the basis of undue prejudice or material hardship. This individual right of appeal would only apply in the case of modification proposals raised by Ofgem.

Ofgem state that under the proposed European codes arrangements, the Agency for the Cooperation of Energy Regulators (ACER) will take a more pro-active role and would be able to raise modification proposals itself to the proposed cross border codes. However, this more pro-active role will be balanced with an individual party right of appeal and we firmly believe that Ofgem should support the introduction of a similar right of appeal in the interests of fair and proportionate regulation.

In our view, such a right of appeal is necessary in order to comply with the requirements of the Electricity Directive which states that:

*"Member States shall ensure that suitable mechanisms exist at national level under which a party affected by a decision of a regulatory authority has a right of appeal to a body independent of the parties involved and of any government."*

It is our understanding that the Directive is to be interpreted in such a way as to give any party affected by any decision of the regulator an individual right of appeal (separate and additional to the right to a judicial review). Therefore, in our view, where an individual party is materially and unfairly affected by a decision by Ofgem to approve or reject a modification proposal on a significant policy change which has been raised (either directly or indirectly) by Ofgem, they should have recourse to a right of appeal. We do not believe that the current arrangements (which were introduced some time ago) would represent "suitable mechanisms" if Ofgem's wide-ranging Major Policy Review reforms are implemented.

We believe that it would be relatively straightforward to introduce such a right of appeal and we would therefore urge Ofgem to begin working with DECC on this issue before the proposals for reform are finalised.

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

If Ofgem is to pursue the Major Policy Review process, it is vital that the process implemented is both transparent and effective. We do not believe that licence conditions compelling other parties to implement Ofgem's preferred reforms will achieve this outcome under a Major Policy Review process. It is also vital that the necessary checks and balances are in place to ensure that no party is unfairly prejudiced by the outcome of a Major Policy Review and we do not believe that at present Ofgem's package of reforms provide the requisite safeguards.

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

Yes, with potential for the scope to be expanded in the future once the processes have been fully established.

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

Yes, in the short to medium term although we would hope that an increasing number of modification proposals would move from the status quo path to the self-governance path once this is proven to be effective.

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

The package of reforms should be implemented across all codes for consistency and transparency.

Chapter Three

*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.

*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?*

Yes we agree with the proposed criteria and welcome the addition of the term "non-trivial" in the criteria for modifications that should be assessed under Path 2. We believe that the criteria should be used more as "guiding principles" rather than set in stone as there would be considerable merit in ensuring flexibility in any assessment of the Path that a modification proposal should take. We therefore do not believe that further guidance is necessary.

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

Yes.

*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?*

Yes to both questions.

Chapter Four

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

We understand the rationale for Ofgem wishing to retain flexibility to vary the process depending on the complexity of the issues involved. However, this must be subject to a requirement to ensure that whatever process is adopted is a demonstrably open and genuinely consultative process.

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

We strongly believe that the only viable, legally robust and transparent means of determining the outcome of an MPR would be Option 3 in Ofgem's paper, that is where Ofgem is vested with the power to raise code modification proposal(s) directly to the relevant panel for independent assessment.

However, this does not mean that Ofgem has to draft the relevant modification proposal and indeed the expertise for drafting the requisite legal text/detailed working of a modification proposal clearly lies within the industry, not Ofgem. We believe that under both Options 2 or 3 industry will need to be fully engaged in the detailed working up of the relevant modification proposals. The key difference between Options 2 and 3 is who raises and owns

the modification proposal (i.e. a licensee directed by Ofgem or Ofgem itself, respectively), while under both options it would require to be worked up via the relevant code modification / industry processes. We have expanded on this point in more detail in answer to Question 1, Chapter 2 above.

*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.*

We are concerned that Ofgem is confusing Options 2 and 3 by using the terms "raising" and "drafting" modifications interchangeably. As we have outlined in response to Question 2 above, Ofgem should clearly have the responsibility to raise modification proposals that it deems necessary following a Major Policy Review, but any such modification proposal would require to be subject to the normal rigours of being worked up in detail and appropriate legal text being drafted by the appropriate industry experts.

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

Given the significant rebalancing of power being proposed by Ofgem, we strongly believe that provision should be made for an individual company right of appeal on the basis of undue prejudice or material hardship. This individual right of appeal would only apply in the case of modification proposals raised by Ofgem. We have expanded on this point in our answer to Question 1, Chapter 2 above.

*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?*

Yes.

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

Ofgem states that it should have the ability to revise its policy or reconsider its MPR conclusions and issue new directions as policy detail develops or if new information comes to light. While we understand the rationale for this, in the interests of fair and transparent regulation such a power must be coupled with an obligation to undertake appropriate levels of consultation on any such changes and an individual company right of appeal on the basis of undue prejudice or material hardship arising as a result of such revisions.

Chapter Five

*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.

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

Yes.

*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.

*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, with one exception. We do not believe that it is reasonable for Ofgem to decline to hear an appeal if it considers the case to have no reasonable prospect of success as this prejudges the outcome and may, in effect, remove a further right of appeal which an appellant may potentially have to the competition commission. This would not represent due process.

Appendix Two

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

It is absolutely key that any package of reforms implemented safeguards all parties' rights in order to ensure that an individual party or indeed industry as a whole is not unfairly prejudiced by the reforms. To maintain a proportionate and fair regulatory framework, we believe that Ofgem must raise modification proposals directly itself (Option 3) and an individual right of appeal against Ofgem/MPR-lead modification proposals should be introduced. Please see our answer to Question 1, Chapter 2 for more detail.

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

We believe that the introduction of self-governance should deliver significant cost savings to Ofgem which we would hope to see reflected in Ofgem's budget requirements going forward.

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

It is absolutely vital that any reforms introduced represent an improvement to the status quo. We firmly believe that this would require the two changes outlined under Question 1 above to be introduced as part of the package of reforms.

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

In our view, the introduction of MPRs would need to be coupled with the two changes outlined under Question 1 above in order to avoid significant unintended risks and consequences.