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

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Dear Mark

I am writing to you on behalf of International Power (IPR) with regard to the illustrative licence modification drafting Ofgem has issued for the three strands of the Code Governance Review. IPR, through a 75:25 joint venture with Mitsui, owns 7% of UK generating capacity, including First Hydro, Rugeley, Deeside, Saltend and Indian Queens. In addition IPR has a small but growing retail supply business, IPM Energy Retail.

IPR has fully engaged with the Code Governance Review undertaken by Ofgem and has submitted responses to all the consultations issued to date. Although we appreciate that Ofgem's intention in publishing the illustrative licence modifications is to aid industry understanding of its initial code governance proposals, the timing of their publication is unfortunate. It would have been more informative and useful had they been published alongside the initial proposals presented in the summer consultations[1], rather than at this late stage in the process. Also, the timing of their publication cannot but create the impression that little serious consideration is being given to industry input in response to the initial proposals. In light of this we would like to stress again our main concerns with the initial proposals.

Loss of structural safeguard

The revisions to the modifications process illustrated in the appendices, especially when viewed collectively (i.e. call in / send back powers in addition to changes due to introduction of the MPR process), represent a major rebalancing of power between industry and Ofgem in the code

[1] Major Policy Reviews and Self-Governance - Initial Proposals (Ref: 84/09), Role of code administrators and small participant/consumer initiatives – Initial Proposals (Ref: 85/09) and Governance of charging methodologies - Initial proposals (Ref: 108/09)

modification process, particularly in areas of most significance. 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. To a great extent the safeguard within the modification process derives from the arrangement whereby Ofgem acts as judge, and industry as initiator of change. In extending Ofgem's role to initiator as well as judge and simultaneously restricting industry's rights to propose change, the structural safeguard inherent in the code modification process is lost. We continue to believe Ofgem will exert undue influence over the code modification process if it is empowered to raise modifications (directly, or indirectly by issuing instruction to the relevant licensee) it will later take decisions on. There is surely a danger that the Authority could be seen as pre-judging any modifications which arise from an MPR.

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. Reform of the gas exit arrangements provides another good example of the shortcomings of the MPR process. We believe that the eventual outcome of gas exit reform, the implementation of 195AV, would have been very unlikely under the MPR process, given the precedence the MPR process would have accorded Ofgem's viewpoints and the time limitations for proposing modifications which would have been imposed on industry. There is a presumption underpinning the proposals for the MPR that there is always an obvious route to reform, a "right answer", as well as a failure to appreciate the value in incremental development of proposals, where proposals build and potentially improve upon earlier proposals.

Lack of Additional Safeguards

Should the MPR process be adopted we believe there is a need for additional checks and balances. 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[2]. We were reassured that the Competition Commission (CC) has been consulted by Ofgem on the access to CC appeal following an MPR however, we still have concerns, in the absence of a formal statement by the CC, about the issue of pre-judgement and whether it will only be feasible to challenge a modification arising from an MPR, not the conclusions of the MPR itself. Of greatest concern however, is the fact that no additional safeguards are being proposed. Additional safeguards, if an MPR process is to be introduced, might include an automatic route to CC appeal for any modification resulting from an MPR, or by introducing the MPR process within a statutory framework rather than by changes to the network licences, which most users have no right to object to.

[2] "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" from '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"

Comments on the Detail of the Draft Licence Changes

Overall, the drafting is consistent with our understanding of Ofgem's initial proposals however it has been difficult to make this assessment in the absence of a consolidated version of the draft licence changes. We have confined our comments here to the detail of the draft licence modifications, not to the merits or drawbacks of the proposals themselves where our views are unchanged from those given in our responses to the summer consultations and outlined above.

Major Policy Reviews and Self Governance

All comments relate to the illustrative drafting for the Condition C3 of the Electricity Transmission Licence however this is just for ease of reference. The comments also apply to the corresponding clauses in Condition C10 and Condition A11 of the Gas Transporter Licence.

4b(iv) – *this allows for alternatives to be raised during the MPR proposal period only if it "is in the opinion of the Authority sufficiently developed to warrant consideration"*
This drafting is too vague and does not give sufficiently clear and specific criteria upon which Ofgem will make this judgement.

4B – *at the end of an MPR Ofgem will publish conclusion which "may be accompanied or followed by directions"*
It is too open ended to allow Ofgem to issue its direction at an unspecified time following publication of its MPR conclusions. The MPR process in this form appears wholly unconstrained. Publication of MPR conclusions should be accompanied by directions or a statement that directions will not be issued. The 'MPR proposal period' during which parties would be entitled to raise modifications within the scope of the MPR would only start at the point Ofgem issues directions. The current drafting could theoretically permit an ongoing moratorium on parties raising MPR related modifications, in a situation where Ofgem persisted in delaying publication of MPR directions.

The relevant panel must "have regard to the Authority's published conclusions & directions" but not be fettered by these when voting
We understand that the intention of this paragraph is to ensure that panel members' voting rights are not fettered by the MPR process. We do not believe the current drafting achieves this. We are concerned that it might prove not prove possible for panel members to both 'have regard' to Ofgem's MPR conclusions and independently judge resulting modifications against relevant objectives. We suggest that there is no need to codify that the panel "shall have regard" to the MPR conclusions and directions. Modifications arising from an MPR should be treated no differently in this respect.

4C – *this allows Ofgem to vary or revoke a direction or raise a modification itself*
It may be sensible that Ofgem is able to vary or revoke directions however this must be constrained in some way. It is not clear from the illustrative draft up to what point Ofgem could exercise this power.

14 – *MPR start and end dates and the MPR proposal period*
In the Summer consultation Ofgem indicated that a modification proposal might 'trigger' an MPR. We do not believe this is reflected anywhere in the illustrative drafting.

The definition of MPR start and end dates could result in MPR's running over many years. It cannot be efficient to prevent parties from raising modifications deemed within the scope of the MPR for such an extended period. The 'MPR proposal period' does not satisfactorily address this fundamental inadequacy in the proposals. Notwithstanding our view that there should be no moratorium whatsoever on a party's right to raise code modification, if a window is introduced, it should be considerably longer than the 2 months being proposed and its timing should be linked to the point at which the MPR related modification is raised. In other words the countdown should only start at this point. This would be more efficient and realistic, allowing parties to raise modifications which build on / improve on the original proposal.

Code Administrators / Small Participant Initiatives

4b(i), (iA) & (ii)
We do not think it is necessary to single out small participants and consumer representatives for 'special treatment' by the code administrator. Given that the code administrator has responsibilities towards all code and other interested parties, there is no need to keep appending "including small participants and consumer representatives", their inclusion goes without saying. It should be the responsibility of the code administrator to support the engagement of all parties, whether large or small, in the code modification process.

14 – *definitions of smaller participants*
The type of definition Ofgem are relying upon to identify small participants is not appropriate. The reality is that some very large organisations might vary considerably in size (judged in this way) depending on the licensed activity. IPR, for example, ships gas to just two offtakes and would therefore be deemed a small shipper; has a small retail supply business and would therefore be a small supplier; owns 6 generating stations so in this instance would not be classed as a small generator, unless the qualification occurs at the level of licence holder, in which case it is likely that some IPR assets might qualify as small generators. So in the case of the BSC and CUSC, IPR could choose whether to present itself as a small supplier or large generator. We think it is likely there will be lots of other instances where similar overlaps occur and think it is not helpful to try and distinguish in this way between smaller and larger participants.

I hope these comments are helpful.

Kind regards

Emma Williams
Market Development