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Dear Mark

## **Codes Governance Review Initial Proposals – illustrative licence modification drafting**

Thank you for the opportunity to provide comments on Ofgem's illustrative licence modification drafting to accompany the Initial Proposals for Major Policy Reviews and Self-Governance; role of code administrator and small participants/consumer initiatives and Governance of charging methodologies.

This response is provided on behalf of National Grid Electricity Transmission plc (NGET) and National Grid Gas plc (NGG). NGET owns the electricity transmission system in England and Wales and is the National Electricity Transmission System Operator. It is responsible for administering the electricity Connection and Use of System Code (CUSC), the Grid Code and the System Operator – Transmission Owner Code (STC). NGG owns and operates the Gas Transmission System and also owns and operates four of the gas Distribution Networks. In association with the three other gas Distribution Network Operators it also jointly provides for the administration of the Uniform Network Code (UNC) Governance arrangements through the Joint Office of Gas Transporters.

As National Grid has already provided responses to Ofgem's Initial Proposals in these three areas, this response is mainly limited to the illustrative licence drafting provided. We have endeavoured to address the three questions you raise in your consultation letter dated 27<sup>th</sup> October 2009.

One area where we wish to provide more substantive comments is for the governance of charging methodologies. We consider that the Initial Proposals document did not make clear that the proposals would apply to connection charging methodologies and thus our response did not cover this aspect. In our view, there is a difference between the nature of connection charging for electricity and gas connections, in that the electricity connectee will have an enduring relationship with National Grid, whereas the gas connectee may not, particularly at the gas distribution level, because the connectee at the distribution level will usually be only the individual consumer or a competitive connection service provider. Furthermore, for gas distribution there is effective competition in providing connections for a substantial part of the market.

This is particularly relevant for the proposed option 3 in which the gas connection charging methodologies would be placed under UNC governance. A gas shipper is not involved at all in the process of connecting a new consumer to the gas distribution network (some suppliers act as agents for distribution network connections, but can choose a variety of competitive service providers). At a gas transmission level, while some connecting parties are shippers, this is not always the case. Therefore, it seems inappropriate to consider including the gas connection charging methodologies for either transmission or distribution within the UNC governance which is the shipper – network operator contract.

Given the points raised above, we question whether it is appropriate to make gas connection charging methodologies open to change proposals from non-network operators. This is an area where it would be appropriate to have different arrangements for the gas and electricity regimes to reflect the different market structures and level of competition in the connections markets.

We also note that the quantitative analysis undertaken by Frontier Economics as part of the Initial Proposals consultation appears to focus specifically on the benefits of allowing parties to submit modification proposals to amend the transportation (use of system) charging methodologies, but not the connection charging methodologies for either electricity or gas. The qualitative analysis, particularly the discussion on impact on consumers, appears to reinforce this focus on the use of system charging methodology. The illustrative licence drafting, however, includes both the connection and use of system charging methodologies within scope of the governance proposals. If Ofgem wishes to implement such a proposal then we feel it is important to consult explicitly on this point.

In addition, we would question the viability of maintaining the existing 28 day veto period under option 2 for changes to both the electricity and gas charging methodologies. As drafted, change proposals would be implemented unless the Authority directed National Grid otherwise. This is inconsistent with other industry open governance arrangements, for example within the CUSC and UNC, and may prove problematic when changes to charging methodologies and those industry codes are required to be progressed in parallel.

We have addressed some broad issues relating to the drafting of each area of the Initial Proposals separately in the appendices to this letter. We would also welcome the opportunity to meet with Ofgem to discuss the licence drafting in further detail at an appropriate stage in the process, as we have a number of detailed drafting comments that we have not included here.

If you wish to discuss this further, or have any queries regarding this response, please contact me, Mark Ripley on 01926 654928 ([mark.g.ripley@uk.ngrid.com](mailto:mark.g.ripley@uk.ngrid.com)) or Richard Court on 01926 656146 ([Richard.court@uk.ngrid.com](mailto:Richard.court@uk.ngrid.com)).

Yours sincerely

*[By e-mail]*

Paul Whittaker  
UK Director of Regulation

## **Appendix 1: Major Policy Review (MPR) and Self Governance**

*Question 1: Does the drafting accord with your understanding of the Initial Proposals?*

*Question 2: Is the drafting sufficiently clear?*

*Question 3: Do you consider the drafting effective in meeting the expressed intention of a particular proposal/option?*

We have provided comments on the illustrative drafting with regard to Ofgem's questions above.

### **a) Ofgem's ability to raise modification proposals pursuant to an MPR**

Paragraphs 2.33 and 4.27 of the Initial Proposals consultation document set out the proposed specific circumstances under which Ofgem would have the ability to draft code modifications itself, following publication of its MPR policy conclusions. The circumstances are: *"in the event that the original modification is not being progressed within the appropriate timescales or does not reflect Ofgem's policy conclusions"*.

However, this does not appear to be reflected in the illustrative drafting, which provides for the Authority to make a modification proposal but does not provide any detail of the circumstances required in order for the Authority to take such action. For example, please see SC C3, para 4C of the electricity transmission licence which states:

*"After issuing a direction in accordance with paragraph 4B, the Authority may:*

*a. [...]*

*b. make a modification proposal."*

This drafting is reflected in SC C10, para 6C for the CUSC and SSC A11, para 15C for the UNC.

### **b) Modification redirection process between Paths 2 and 3**

We do not consider that the illustrative licence drafting includes the proposal for the redirection process set out in paragraphs 3.43 and 3.44 of the Initial Proposals consultation document, whereby consumers or code parties could request for modification proposals to be redirected from Path 3 into Path 2. We would appreciate clarity as to whether Ofgem envisages that these provisions would be set out within the relevant code as opposed to the licences.

### **c) Lack of direction following MPR conclusions**

The illustrative drafting does not appear to cater for the situation in which no direction is made by the Authority in relation to an MPR (see electricity transmission SC C3, paragraph 4B and SC C10, paragraph 6B and gas transporter SSC A11, paragraph 15B).

### **d) Definition of "MPR"**

We consider that the proposed definition of MPR within the illustrative drafting does not fully capture the scope of such reviews described within the Initial Proposals, since it does not cover all of the criteria set out in paragraphs 3.23 and 3.24 of the July consultation document, as follows:

*"3.23. We propose that Ofgem should have the ability to initiate an MPR where a modification proposal exhibits one or more of the following characteristics:*

- the proposal is likely to have significant impacts on competition or on gas and electricity consumers (this may be based on a qualitative assessment since the idea is to streamline the process and not to add another stage to it);*
- the proposal is likely to create significant cross-code or code-licence issues. Paths 2 and 3 may be inappropriate when a modification raises an issue that could require changes to more than one code, licence or set of charging arrangements; and/or*
- the proposal is likely to have significant impacts on the environment, sustainable development or security of supply.*

3.24. We believe that we should also have the ability to initiate an MPR in response to Government policy decisions or unforeseen circumstances that appear to Ofgem to require us to consider the case for major policy reform."

**e) Definition of "self-governance statement"**

For clarity, we suggest that "self-governance statement" should only be defined once within the licence drafting. Within the illustrative licence drafting provided, it is defined twice in each relevant licence condition; so in SC C3, it is defined both in paragraph 13Ab(i) and paragraph 14; within SC C10 it is likewise defined in paragraph 13Ab(i) and paragraph 15; and within SSC A11 it is defined in paragraph 15Db(i) and paragraph 24.

**f) Inclusion of Self Governance arrangements within code modification procedures**

Although we understand that the self-governance arrangements have yet to be finalised, we wish to clarify the extent to which procedures relating to the self-governance route should be reflected in the codes. We are uncertain due to the different requirements in the illustrative drafting for the CUSC and the UNC.

The illustrative drafting in SSC A11 6b for the UNC appears to suggest that the self-governance route would not be covered by the network code modification procedures.

In contrast, the illustrative licence drafting for the CUSC in SC C10, para 6aB requires the procedures for modification of the CUSC to include the *"implementation of modification proposals without the Authority's approval in accordance with paragraph 13A (the "self-governance route")*.

**g) Threshold for determining what modifications may be made without the Authority's consent**

The proposal that modifications may be implemented without the Authority's consent (see, for example, electricity transmission SC C3 paragraph 13A) appears to be drafted very narrowly. The use of a threshold or test based on the concept of "triviality" does not seem to be appropriate here, as it will lead to significant debate as to what should be considered "trivial". It would be preferable, therefore, and would clarify the drafting without changing the policy thrust of the drafting, if the thresholds in paragraph 13A were defined in terms of "materiality" instead. This will make this a more viable route for modifications to proceed along.

That said, we do consider that a test of whether an appeal is "trivial" is the right threshold in SC C3 paragraph 13B(c) when identifying unmeritorious appeals against self-governance decisions.

**h) References to Special Condition J**

Specifically for NGET's electricity transmission licence only, the drafting needs to be updated to reflect the fact that BETTA has now been fully implemented and Special Condition J deleted in 2007. As a result, the references to that special condition should be removed and the definition of "transition modification provisions" deleted in standard condition C3 (Balancing and Settlement Code (BSC)).

## **Appendix 2: Role of code administrators and small participants/consumer initiatives**

*Question 1: Does the drafting accord with your understanding of the Initial Proposals?*

*Question 2: Is the drafting sufficiently clear?*

*Question 3: Do you consider the drafting effective in meeting the expressed intention of a particular proposal/option?*

We have provided comments on the illustrative drafting with regard to Ofgem's questions above.

### **a) General considerations**

In line with our response to the Initial Proposals consultation, we consider that while a high-level licence obligation on the code administrator to provide targeted assistance to small participants and consumer representatives may be appropriate, a more flexible approach would be to include the detail of the obligation in the relevant code or proposed code administration code of practice. The illustrative licence drafting provided includes both a high-level obligation on and a non-exhaustive list of activities of the code administrator (for example, electricity transmission SC C10, paragraph 6b(iA)).

### **b) Appointment of independent chairperson**

We would appreciate greater clarity over the wording of the illustrative drafting relating to the appointment of an independent chairperson for either the UNC or CUSC Panels. Paragraph 2.51 in the Initial Proposals consultation document confirms Ofgem's intention that *"the Authority becomes responsible for appointing the chairs of the CUSC and UNC panels"*. The illustrative licence drafting in respect of both codes, however, refers to *"an independent chairperson who has been approved by the Authority"* (SC C10, para 2e. and SSC A11, para 6d(i)).

We would like to understand whether Ofgem considers there to be a difference between the Authority "appointing" or "approving" a chairperson.

### **c) Appointment of a voting consumer representative to the UNC Panel**

Similarly, we would appreciate greater clarity on the intention behind the illustrative licence drafting within SSC A11, para 6d(ii) in terms of whether there is any requirement on the licensee to suggest to the Authority a pool of potential candidates from which the Authority could approve a consumer representative.

### **d) Creation of a "code administrator"**

The illustrative licence drafting for both CUSC and UNC creates the concept of a "code administrator", defined as *"a secretarial or administrative person or body"*. While we agree that this is in line with the Initial Proposals, we wish to ensure that the existing arrangements for the CUSC and UNC can be accommodated by this definition.

For the CUSC, there is no "body" established as code administrator, rather a number of individuals within National Grid undertake this role.

For the UNC, the code administration arrangements are set out within SSC A12 of the licence (Joint Governance Arrangements) and the role is fulfilled by the Joint Office of Gas Transporters, although this is not specified within SSC A12.

### **e) "Call in" powers**

We consider that there is an unintended consequence to the structure of the illustrative licence drafting for the proposed "call in" powers set out in SC C10, para 6d and SSC A11, para 9fA. In both cases, the "call in" powers refer back to the section of the licence which requires modification procedures to be established for both codes. A new clause has been added to this section for the assistance to "small participants" and consumer representatives. This means that the "call in" requirements for provision of a timetable to the Authority for completion of certain steps also covers the provision of assistance, such as drafting a modification proposal, to small participants and consumer representatives.

We do not consider that the Initial Proposals included a requirement for a code administrator to provide a timetable to the Authority for providing assistance to small participants and consumer representatives or to complete such tasks within a specified timescale.

## **Appendix 3: Governance of Charging Methodologies**

Notwithstanding our stated preference for Option 3 in our response to the Initial Proposals consultation, we have provided comments on the licence drafting for both options 2 and 3 below, in line with Ofgem's questions.

*Question 1: Does the drafting accord with your understanding of the Initial Proposals?*

*Question 2: Is the drafting sufficiently clear?*

*Question 3: Do you consider the drafting effective in meeting the expressed intention of a particular proposal/option?*

### **Option 2: Refining the existing licence arrangements**

There are a number of areas where we would appreciate greater clarity in the illustrative drafting, set out below.

#### ***a) Implementation of modifications that better achieve the relevant objectives***

This issue relates solely to the electricity licence drafting. The existing licence drafting in SC C5 para 2 and SC C6 para 3 state that *"the licensee shall [...] make such modification of the charging methodology as may be requisite for the purpose of better achieving the relevant objectives."*

We are uncertain as to whether this licence drafting will continue to work as intended if option 2 is implemented. We consider that option 2 removes absolute ownership of the charging methodologies from the licensee and therefore introduces an additional element of subjectivity into the assessment of whether a proposal better achieves the relevant objectives. We question whether the clause as currently drafted would still require the licensee to make a modification, raised by a third party, which it considered did not better achieve the relevant objectives.

#### ***b) Alternative charging modification proposals***

Paragraph 4.12 of the Initial Proposals consultation document sets out the requirements on Network Operators to have certain arrangements in place to allow modifications to be proposed to charging methodologies. One of those is to allow *"open consultation on the merits of the proposals and any alternatives"* and for the production of a report that sets out *"the original proposals and any alternatives"* and a recommendation to the Authority.

The illustrative licence drafting for Option 2 retains Ofgem's "right to veto" (e.g. within SC C5, para 4 for electricity transmission). This means that, unless the Authority directs the licensee that a modification should not be made within 28 days of receiving a report, the licensee will make the proposed modification. It is not clear to us exactly how the "right to veto" approach would work if the report contained two or more conflicting alternative proposals, even if National Grid were to recommend one of the options proposed.

Furthermore, as highlighted above, we question whether the retention of a 28 day "right to veto" is a pragmatic proposition going forward under open governance arrangements given its inconsistency with other industry change procedures governed in this manner. We consider that this time limit may prove problematic when changes to charging methodologies and other codes are required in parallel.

#### ***c) Making changes to the arrangements for handling modification proposals***

The illustrative licence drafting contains an obligation on the licensee to *"establish arrangements for the handling of modification proposals"* (e.g. electricity transmission SC C5, para 3 (a)). The drafting is silent on whether there are any requirements relating to changing those arrangements, once established. We have assumed that National Grid would be free to amend the arrangements as it sees fit, as long as any changes still meet the licence objective relating to the arrangements.

#### ***d) Time window***

The illustrative drafting provided for the "time window" proposal is worded in such a way that it is difficult to see how it could be binding upon a third party (e.g. electricity transmission SC C5, para 9).

### **Option 3: Industry codes governance**

#### **e) Structure of gas transporter licence conditions**

In relation to option 3, we have a major concern that the proposed approach to the modification of gas transporter licences will have unintended consequences. Since:

- standard conditions apply to all gas transporter licensees, including gas DN operators and IGTs; and
- Standard Special Conditions in Part A of the NTS and DN licences apply to all NTS and DN licensees

the proposed changes will affect all of these licensees, while we understand that the policy objective is only to make the changes applicable to the NTS licensee, at least initially. In order to avoid this, the policy should be implemented by:

- “turning off” standard condition 4B (Connection Charging Methodology) in the NTS licence and replacing it with a special condition in that licence only; and
- making NTS licence-specific changes to the relevant Standard Special Conditions in Part A by means of a Special Condition applicable to the NTS licensee only (as is done at present in order to deal, for example, with the issues raised by LNG storage).

This approach will ensure that the changes are targeted at the intended (NTS) licensee without having any wider impact.

#### **Options 2 and 3**

The following issues affect the illustrative drafting for both options 2 and 3.

#### **f) Definition of "affected parties"**

The proposed definition of "affected parties", those who would be permitted to raise a modification proposal, within the illustrative drafting is currently vague.

*"affected parties means any CUSC user, the National Consumer council, BSC Parties and any person or class of persons designated by the Authority for this purpose".*

*"affected parties means relevant shippers and/or DN operators as appropriate and any person or class of persons designated by the authority for this purpose".*

We would appreciate greater clarity over who Ofgem considers the Authority may designate as an "affected party" and when such designation may occur. This would assist us in providing transparency and consistency of arrangements and certainty to any organisation (or individual) not explicitly specified in the definition who may consider raising a proposal under the new arrangements.

Notwithstanding our previously stated preference to prioritise governance changes in gas transmission over gas distribution, we would particularly appreciate clarity with regard to the definition of "affected parties" with relation to the gas distribution charging methodologies. "Affected parties" could be considered to include domestic consumers, small businesses in the Industrial and Commercial sector, independent gas transporters and representatives of all of these parties, for example, organisations such as the Major Energy Users' Council and the Energy Intensive Users' Group.