Charles House
5-11 Regent Street
London
SW1Y 4LR
Tel: 020 7930 9390
Fax: 020 7930 9391
enquiries@aepuk.com
www.aepuk.com

FAO Mark Cox
Associate Partner, Industry Codes and Licensing
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

12th May 2010

Dear Mark

AEP response to Codes Governance Review Final Proposals

We welcome the opportunity to comment on the final licence modification proposals in support of the Ofgem-led code governance review. This consultation response has been compiled following discussions at our Electricity Networks, Electricity and Gas and Electricity Trading Committees who have raised a number of concerns and points for further clarification.

Timing

Given that this review has been ongoing since November 2007 it is rather surprising, with several issues still to be clarified, not least identification and development of the consequential wide ranging changes to the three industry codes, that Ofgem is now forcing the pace with regard to implementation.

To illustrate our concern I have drawn upon the example timetable provided to the Connection and Use of System Code (CUSC) Panel following our meeting 30th April 2010. Ofgem stated at the panel meeting that it expects the final CUSC Amendment proposals to be given full effect by 1st November 2010. Meeting this timeframe would require a raft of CUSC Amendments, which includes transferring the governance of all charging proposals to within the code, to be raised by 13th May in order to be presented to the May 21st CUSC Panel. This is not a trivial task.

The proposals would then be submitted to and processed by a CUSC Working Group who would develop its Working Group Consultation with its ten day consultation period. Responses would then need to be considered by the

CUSC Working Group who would then have to assess the Amendments against the applicable CUSC objectives and submit its findings to the 30th July 2010 CUSC Panel. The timeframe from the May CUSC Panel meeting to the July Panel paper day is nine weeks. This includes development, evaluation, consultation and assessment of the Amendments by the Working Group. Following the July Panel meeting National Grid would then need to prepare its Company Consultation, taking into account the views of the CUSC Panel. This would then need to be issued in early August for consultation. Note that this is traditionally a difficult time for stakeholders due to the summer holiday period and one during which we normally would allow extra consultation response development time. Once responses are received and the report updated with industry views, it would need to be returned to the 27th August CUSC Panel meeting for final decision.

The Final Report would then need to be submitted to the Authority by 13th September 2010 at the latest in order to enable it to make its final determination, which, assuming the 25 day decision time KPI standard is followed and a 10 day implementation period, meets the 1st November 2010 timetable provided that Ofgem has not changed its view that there is no need for a Regulatory Impact Assessment. Given the number of energy related issues currently under review it is likely that the CUSC process will struggle to support this aggressive timetable.

The industry is yet to begin discussions on the approach to handling change proposals which would be processed via the self governance route. This is not an insignificant amount of work to be completed under this challenging timescale.

The Authority to Direct Licensee to raise Change Proposals

Members have raised concern that Ofgem will immediately seek to 'direct' the Licensee to raise modification/amendments rather than, in the first instance, producing a conclusions report which highlights identified deficiencies and provides an overview of options for change, to which the industry can then respond. Members had envisaged a process much like the one followed during the review of transmission access during which Ofgem and DECC published joint reports culminating in a raft of code amendments being raised by National Grid.

It would be preferable for the industry to initiate any proposed changes rather than for the Authority to direct the Licensee as this would not lead to any question about its independence in this matter. As many respondents have commented, there is real concern that the Authority would be acting in the capacity of both judge and jury.

In addition there is a question about the suitability of this task being directed towards the Licensee for matters with which it does not retain any expertise, for example Smart Meters. Of particular concern here is the newly introduced provision which prevents the Licensee from withdrawing any change proposal that the Authority has directed it to develop. If the proposal is subsequently

found to be lacking or inappropriate following scrutiny by the industry then there should be no limitation to the overriding industry governance provisions. This will restrict National Grid from expressing real concern where it finds it is in accord with the industry view and not with Ofgem.

Against this background, it is absolutely vital that the licence drafting setting out the Significant Code Review process is clear and sufficiently detailed to ensure that industry as a whole has the necessary transparency and clarity following a Significant Code Review process. We do not believe that it is sufficient for the relevant licence conditions to simply state that the licensee will be "issued directions by the Authority, the licensee shall comply with those directions".

Rather, there should be an explicit requirement on Ofgem to provide clear and sufficiently detailed instructions to the licensee; the timetable set by Ofgem should only begin once the licensee has confirmed that they fully understand the direction(s); and the licence condition should set out what constitutes compliance with the licence obligation. We have therefore suggested some additional text to the original licence drafting in bold italics in the attached Appendix 1.

The Appeal Provisions

Members continue to express concern about the appeals mechanism Significant Code Reviews and require further clarification as the provisions have changed since last consultation. Members believe there should be a Competition Commission appeal provision when each decision process takes place and not only when a modification has been approved or rejected at the end of the Significant Code Review. It would also be appropriate to include this provision when Ofgem *decide* what a solution should be following a Significant Code Review and subsequently *directs* that a modification is to be developed by a licensee. Further to this members would expect to see that there should be a final Competition Commission appeal option at the end of the Self Governance route. This would be after the Ofgem appeal process (or, potentially, instead of the suggested Ofgem appeal route, given that Ofgem can overrule routing decisions for a given modification at the start of the process). As an absolute minimum, individual companies should have the right to appeal Ofgem's final decision whether to accept or reject a Significant Code Review related modification.

One issue which members are struggling to understand is the rationale behind why, given that alternatives can be raised, Ofgem may decide not to progress them until the point at which a decision in support of its favoured outcome has been reached. It should be a requirement that all changes related to a Significant Code Review topic whether they be variants to the original or an entirely different approach should be considered at the same time and a decision made on the same day.

The Current Code Objectives

Clarification that all of the existing code objectives remain fit for purpose would be appreciated given that the Authority will be creating wider powers and directing a change.

The Appointment of Code Panel Members

We are concerned that the composition of the panels has changed significantly over time to the extent that in some cases it is now questionable how representative they are of "industry's" view. This has significant implications given that any right to challenge an Ofgem decision whether to approve or reject a modification proposal is determined solely by the "industry panel's" vote, that is whether the panel's vote reflects or is at odds with Ofgem's decision.

As a consequence, while we accept the rationale for a consumer representative to be appointed onto the panels with a right to vote, in the interests of maintaining an appropriate balance of interests on the panels this must be limited to one consumer representative with one voting right. Ofgem should not therefore have the power to appoint any other consumer representative with an associated vote onto the panels.

Self Governance

Ofgem is expecting that industry will develop its own proposals on the management of the self governance route and then submit the final proposals to Ofgem for ratification. It will be challenging to achieve agreement on all aspects of this proposal in time to reach the 13th September deadline.

The final proposals include a 28 day window for Ofgem to consider whether a Panel has correctly identified a proposal as being eligible to be processed via the self governance route. There is no explanation of why Ofgem would require such a long time frame. The Panel only has up until the panel meeting from the time the change proposal is raised to reach a view. Why is Ofgem unable to do so in the same timescale? The Panel is required to consult on its decision. The consultation would be incomplete without the inclusion of an Ofgem view on whether this decision was right or wrong. The consultation would presumably allow a maximum of ten days for industry response. A 28 day delay before the Panel can issue the consultation is not appropriate.

Ofgem should be in a position to provide a view on the accuracy of the Panel decision at the Panel meeting to which the proposal is presented in order not to delay industry deliberations on the merit or otherwise of the proposal. If this provision remains then it is possible, in an extreme example that, a proposal which missed a particular panel meeting could be left in limbo for around 10 weeks before entering into either stream of the governance process. We do not yet know what the process is for treatment of a proposal for which the panel and industry do not agree the route.

Code Administrator Code of Practice and Associated KPI's

We do not advocate mandating the adoption of the Code Administrator Code of Practice via licence condition at this time but would recommend that the document and particularly the associated KPI's be allowed to develop in light of industry and Code Administrator experience. Many of the KPI's proposed may be useful metrics for monitoring and benchmarking the overall modification processes but few are specifically within the gift of the Code Administrator to fully influence. It would therefore be inappropriate to consider them as Code Administrator performance measures. More detailed comments on each proposed measure are provided in Appendix 2. We note however that there are no KPIs proposed in relation to costs.

With regard to the Code of Practice we believe that it is appropriate to allow more than one alternative under the BSC and the UNC. We support the provision to limit the Ofgem decision making time to 5 weeks although we assume this may be extended if Ofgem need to undertake a Regulatory Impact Assessment.

We do not understand how a Code Administrator will be able to 'raise modification issues that are relevant to small market participants' in relation to their role as Critical Friend. It is unclear how the Code Administrator could do this other than reading out a statement as it will have no direct experience of the small market participants' business. This provision appears to be in direct conflict with the requirement to 'remain impartial'.

Principle 4 of the Code sets out an amendment and review process for the Code, including who can propose amendments, the type of consultation required and that such amendments are to be subject to Authority approval. Given that Ofgem is proposing to introduce a licence obligation on licensees to adhere to the principles of the Code, the process for changing the Code must be both clear and robust. In our view, as it stands, Principle 4 outlines an overarching change control process but provides very little detailed governance around such a process.

In particular, we believe that clear rules must be established for determining who can raise an amendment and what recommendation is made to the Authority on suggested amendments. We strongly believe that it would be inappropriate for Code Administrators to be able to propose amendments to the Code of Practice as this would be detrimental to their objectivity; rather it should be the relevant Code Panels' role to propose amendments to the Code of Practice (as is the case, for example, with the BSC code modifications, where the Administrator presents the justification for a change to the Panel and a change proposal is raised, in the Panel's name).

This will ensure the 'checks and balances' of good governance are maintained. Otherwise there is a risk that, as an interested party in the outcome of a Code of Practice change, the Code Administrators might be perceived as promoting a change for their own benefit. The respective independent Panels would act as a curb on any such tendencies.

In addition, in our view, the most appropriate approach at this stage would be to require unanimous support from the relevant Panels before an amendment is recommended for approval by the Authority. This approach would also allow other Code Administrators to voluntarily adopt the Code of Practice as they would know what they are signing up to and what the arrangements are for governing changes to those requirements.

Under quality of assessment, Ofgem propose a KPI of "number of final decisions in line with panel recommendations" with an associated target of the number increasing over time. While we understand the rationale for recording this information, we do not support the target of increasing the number of decisions in line with Panel recommendations. We do not agree "the aim of the proposer and to an extent the Code Administrator and panel should be to ensure that any proposal that has gone full term has the best possible chance of being accepted". There may be wholly acceptable reasons why the Panel's recommendation is not in line with the Authority's final decision.

We also believe that the requirement to produce and consult fully on legal text prior to a modification proposal being recommended for approval/rejection to the Authority should form a KPI. In addition, the 'critical friend' KPI should be, in our view, restricted to those parties receiving special assistance from the Code Administrators i.e. small participants.

Impact Assessment Assertions

The £100 million cost savings within the Regulatory Impact Assessment using the P217 Cashout Proposal as the example are rather exaggerated in that a Significant Code Review would probably not have reached this point as the idea behind the P217 proposal evolved over time and did not form part of the initial discussions on electricity cashout.

If you have any enquiries regarding this response please feel free to contact Barbara Vest, Head of Electricity Trading on 07736 107 020

Yours faithfully

David Porter OBE
Chief Executive

(By Email)

A COMPANY LIMITED BY GUARANTEE
REGISTERED IN ENGLAND AND WALES
COMPANY REGISTRATION NUMBER 2779199
REGISTERED OFFICE AS ABOVE

APPENDIX 1

"15C (a) (i) ***clear and sufficiently detailed*** instructions to the licensee/relevant gas transporters(s) to make and not withdraw without the Authority's prior consent a modification proposal;

(ii) the timetable for the licensee/relevant gas transporter(s) to comply with the Authority's direction, ***only to begin once the licensee has confirmed to Ofgem that they fully understand Ofgem's instructions***; and

15C (c) The requirements of paragraph 15C (a) shall be treated as satisfied in respect of a particular modification proposal where the licensee has undertaken reasonable endeavours to raise a modification proposal as directed by the Authority under paragraph 15C (a) above."

APPENDIX 2

Quality of Assessment – Number of reports 'sent back' by the Authority

It is not clear to what extent this can be influenced by the Code Administrators. In one respect they can encourage appropriate analysis and challenge how a proposal may meet the relevant objectives but ultimately this responsibility sits with the Panel to determine whether a proposal is adequately developed to proceed to consultation or not. In any event the decision to send back a proposal is made by the Authority and it could be argued that this measure more precisely reports a deficiency in Ofgem's engagement in the Workgroups.

Number of final decisions in line with panel recommendations

It is not clear what this is trying to achieve; to influence Ofgem to make decisions in line with panel recommendations or perhaps to influence the panel to make recommendations in line with Ofgem's likely views. We consider this inappropriate as a performance measure for the Code Administrators but it may be a useful metric for reporting alongside the percentage of decisions it makes within the 5 week window.

Effective Communications – Glossary and plain English summary with reports

We welcome this provision but would anticipate that they would become part of a modification template and will therefore be provided routinely once developed.

Number of respondents to consultation

Whilst this may be interesting to monitor it should not necessarily be a performance metric for the Code Administrators. Resource constrained parties who agree with a particular proposal may not submit a response, this and other issues is not in the gift of the Code Administrators. A Code Administrator cannot force stakeholders to respond in order to show improvements. It would be more appropriate to design a measure that considers awareness of such proposals rather than whether a response is submitted, and therefore may more appropriately sit as a qualitative measure as part of the 'critical friend' survey. In addition, should this provision be retained, clarification regarding how this would be measured will be required. Some large companies hold multiple licences and provide a single response would this count as one or a number reflecting the number of licences it represents?

Percentage of' bounced' or unsuccessful emails

Whilst we accept that ideally these should be kept to a minimum, using this as a performance measure may simply lead to parties being deleted from distribution lists rather than allowing time to determine the reason for an unsuccessful email and as such this may be an undesirable consequence. The Association has experience of managing large distribution lists and on occasion transient IT problems or full mailboxes lead to unsuccessful email delivery these often resolve themselves in a few days. If not further enquiries are made of the company to check that email is still valid. As such an unsuccessful email cannot be directly attributable to the sender.

Efficient administration - Papers to be published within [x] days of the meeting.

We consider this would be better if it was more specific for example agendas to be published no later than 5 working days before the meeting. Draft Minutes to be published no later than 5 working days after the meeting.

Numbers of reports submitted to the Authority in line with the original timetable

The Association does not consider this is very clear, in respect of which reports? Presumably this refers to Final Modification Reports? Clarity is also required with regard to how the original timetable is established, when and by whom. The indicative timetable in Annex I notes the assessment and development phase could be between 3-6 months.

Number of extensions to timetable

These may be usefully monitored and reported but not necessarily as a performance measure for the Code Administrators. Extensions are more likely to result from the workgroup considered complex issues and any pressure to squeeze timescales is only likely to lead to lower quality analysis and

modification reports. A change to a timetable is rarely a measure of failure or poor performance.

Average lead time between decision and implementation

Again this may usefully be monitored but used with caution since a long lead time between decision and implementation may be perfectly reasonable and acceptable in some circumstances. For example: where an early decision is required to provide clarity but actual implementation may be sometime later. Clarity would also be required on what implementation means? Does this refer to incorporation of legal text in the Code or delivery of systems to support the change?

Implementation costs – Implementation cost estimates to be produced and consulted upon prior to a proposal being recommended for approval

It is not clear which implementation costs are to be considered here. Does this refer to Network Operators costs and/or the costs of other market participant? In any event it is not entirely within the gift of the Code Administrators to obtain these cost estimates in all cases.

Accuracy of estimates to actual implementation costs

We acknowledge there is rarely a post-implementation review of costs, and such information may be informative but it is not clear how readily available such information is. Again it is not clear whose costs are to be considered.

Critical Friend

We would support a survey to assess the quality of assistance provided rather than the quantity.