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Our Reference:

Your Reference:

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Dear Jon,

Codes Governance Review: Final Proposals Licence Drafting Consultation

Thank you for the opportunity to comment on the above.

As you are aware, we have two fundamental concerns about Ofgem's proposals on code governance, namely the introduction of an open-ended, generic licence condition and companies' rights of appeal. In particular, given that Ofgem make the final decision as to whether a modification proposal is approved or rejected, we firmly believe that in order to preserve an appropriate balance of rights across the parties, Ofgem's package of proposals should include provision for an individual company right of appeal on the basis of undue prejudice or material hardship. Just to be clear, this individual right of appeal would only apply in the case of modification proposals raised by Ofgem following a SCR process.

We have set out our views at length on both the proposed licence condition and the lack of appropriate appeal rights in our earlier responses to Ofgem's consultation papers and as such, we will not repeat them here. We are very disappointed to note that Ofgem has not taken any action to address industry's concerns on either of these two vital issues. In addition, while we welcome the publication of a licence drafting consultation we also have three significant concerns about the practical implementation of Ofgem's proposals. We have set these out in turn below and our detailed comments on the draft licence amendments are attached as Appendix 1.

Licence Compliance

Under the licence drafting proposed by Ofgem (DN Gas Transporter Licence, Standard Special Condition A11: Network Code and Uniform Network Code, paragraph 6), licensees are required to have prepared the UNC which meets, amongst other things, the requirements of the Code Administration Code of Practice, provides for the changes required to the panel's composition and the incorporation of the UNC charging methodologies, by the date at which the licence condition becomes effective. However, our understanding is that Ofgem intend to issue the statutory consultations on the licence amendments in late May, with the licence changes coming into effect in late June.

Clearly, it will not be possible for all the modifications to industry codes to have been raised, debated and approved by Ofgem before the licence changes come into effect in late June and this therefore needs to be reflected in the licence drafting. That is, we cannot accept licence amendments which when implemented would immediately place us in breach of our licence. Paragraph 23A of the same condition may be designed to address this timing issue and if so, paragraph 6 should state that it is “subject to paragraph 23A of this condition”. It would also be helpful if Ofgem could confirm that the intention of the proposed licence drafting is that licensees must have implemented the necessary changes to the industry codes by no later than 1st November 2010 (and not by the date that the licence changes come into effect).

It is also clear that we can only consider accepting licence amendments which we believe we can reasonably comply with. That is, the licence drafting setting out the SCR process places a clear obligation on the licensee to raise a modification proposal(s) within the timetable set out by Ofgem. This is very open-ended and we believe that there needs to be some additional detail set out in the licence in terms of the process that the licensee is required to follow in order to have satisfied this licence obligation.

In particular, we believe that there needs to be an explicit requirement on Ofgem to provide clear and sufficiently detailed instructions to the licensee before they can raise a modification proposal in line with Ofgem’s direction; the timetable for the licensee to comply with Ofgem’s direction only to begin once the licensee has confirmed to Ofgem that they fully understand Ofgem’s instructions; and a clause setting out what constitutes compliance with this licence obligation. We have therefore suggested some additional text to the licence drafting in the attached Appendix, DN Gas Transporter Licence, Standard Special Condition A11, paragraph 15C (a).

Integrity of Network Operators’ (NWOs’) Price Control Settlement

As we have stated throughout the code governance review process, we fully support opening up the Transmission charging methodologies to change proposals by network users and customers and, in our view, the best way of achieving this is by incorporating the charging methodologies into the relevant industry codes. We therefore welcome Ofgem’s decision in relation to charging methodologies.

However, we also firmly believe that in opening up the charging methodologies, the integrity of NWOs’ price control settlements must be protected in order to avoid windfall gains/losses to NWOs. For example, modification proposals seeking to change the boundary between use of system allowed revenue and the customer contribution element of connections charges would very likely require a re-opening of the price control settlement mid-price control. The potential for this to happen would significantly increase the regulatory risk faced by NWOs.

We believe that this risk could be effectively managed by Ofgem when assessing charging methodology modification proposals that would have a material impact on licensees cashflow and/or price control settlement. That is, where such a modification proposal is identified and if Ofgem are minded to approve, they could stipulate an implementation date in line with the next price control period. Alternatively, an earlier implementation date could be agreed subject to Ofgem committing to agree appropriate compensation / recouping of monies from the relevant licensee(s) in the next price control period. To this end, we have suggested some additional text to the licence drafting in the attached Appendix (re. Condition C10 of the

Electricity Transmission Licence and Standard Condition 4B of the NTS Gas Transporter Licence) which we believe would help mitigate this regulatory risk.

Composition of Panels

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.

If you would like to discuss any of the above in more detail, please do not hesitate to call.

Yours sincerely

Rhona McLaren
Regulation Manager

Appendix 1: SSE Comments on Draft Licence Amendments

Question 19

As a general point, Ofgem's proposed licence changes include the addition of a number of new defined terms, some of which do not have capital letters to indicate that they are defined terms. It is clearly important to ensure consistency in licence drafting and clarity where a term has an associated definition and all defined terms should therefore have capital letters.

DN Gas Transporter Licence

Standard special condition A4 : Charging – General

We welcome Ofgem's recent decision to retain paragraph 8(b). We believe that this is appropriate as it is important that different methodologies are not confused. This paragraph refers to other methodologies and charges, such as user pays charging methodology, failure to interrupt charges, ratchet charges, etc. These are already governed separately under the UNC and this should not be changed.

Standard special condition A5: Obligations as Regard Charging Methodology

In paragraph 1, we believe the phrase "of this condition" should be inserted after 'subject to paragraphs 2, 2A and 3'. Also, the number 2 from paragraph 2 should not be deleted as it is referred to in paragraph 1.

We also note that Ofgem has inserted two new paragraphs at the end of this licence condition (10A and 10B) which are designed to provide transitional arrangements for dealing with charging methodology modification proposals until 1st November 2010. While we agree with the need for such transitional arrangements, we do not believe as currently drafted that these conditions work as they contain references to "the report" being furnished to the Authority but provision for furnishing such a report to the Authority under paragraph 2 has been deleted. This therefore requires further drafting to ensure that the transitional arrangements are robust. One possible approach would be to retain paragraph 2 as a sunset clause to last until Ofgem has approved the modification proposal(s) that transfers the charging methodology arrangements into the UNC modification procedures.

Standard Special Condition A11: Network Code and Uniform Network Code

Questions 14 and 15

i) Under paragraph 6, licensees are required to have prepared the UNC which meets, amongst other things, the requirements of the Code Administration Code of Practice, provides for the changes required to the panel's composition and the incorporation of the UNC charging methodologies, by the date at which the licence condition becomes effective. However, our understanding is that Ofgem intend to issue the statutory consultations on the licence amendments in late May, with the licence changes coming into effect in late June.

Clearly, it will not be possible for all the modifications to industry codes to have been raised, debated and approved by Ofgem before the licence changes come into affect in late June and this therefore needs to be reflected in the licence drafting. Paragraph 6 should therefore state that it is "*subject to paragraph 23A of this condition*".

It would also be helpful if Ofgem could confirm that the intention of the proposed licence drafting is that licensees must have implemented the necessary changes to the industry codes by no later than 1st November 2010 (and not by the date that the licence changes come into effect).

Questions 7 and 20

ii) Paragraph 6 d (ii) states that the panel's composition shall include *“a consumer representative (appointed by the National Consumer Council or any successor body [and any other consumer representative as may be appointed by the Authority].”*

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. We therefore believe that the text in square brackets and underlined above should be deleted and Ofgem should not have the power to appoint any other consumer representative with an associated vote on the panel.

In addition, paragraph 6a, the word “and” should be deleted at the end of the paragraph; paragraph 6b, insert “;” at the end of the paragraph; and paragraph 6c should refer to “Standard Special Condition A12”, not “Special Standard Condition A12”.

iii) Paragraph 9aB (ii) should refer to paragraph 2A of Standard Special Condition A5 also.

iv) Paragraph 9dA, we do not understand the purpose of the term “proper” in front of evaluation and believe it should be deleted.

v) Paragraph 10b states that any of the parties listed in paragraph 10(a) can raise alternative modification proposals. However, a person should only be able to raise an alternative modification if they are in the category that can raise an original modification i.e. paragraphs 10(a), 10(aA) or 10(aB) and paragraph 10b should reflect this.

vi) Paragraph 15A prohibits parties listed in paragraph 10(a)(i-iv) from raising modification proposals during phase 1 of a significant code review. In our view, this prohibition should also apply to charging methodology modifications and therefore paragraph 15A should also refer to paragraph 10(aB).

Questions 6 and 20

vii) Paragraph 15B is an improvement from the original draft licence amendments which introduced a whole new assessment and consultation process for modification proposals *before* such a proposal is even accepted into the modification procedures. However, we note that the panel shall not proceed with the modification proposal without the Authority’s prior consent. This would be very bureaucratic, would slow down industry code governance significantly and would go against the aims of the code governance review. We therefore

believe that this requirement should be amended to allow the panel to proceed unless the Authority object within a set period after receiving notice from the panel of their intention.

viii) We can only consider accepting licence amendments which we believe we can reasonably comply with. That is, the licence drafting setting out the SCR process places a clear obligation on the licensee to comply with directions issued by Ofgem, which may include a requirement to raise a modification proposal(s) within a timetable set out by Ofgem. This is very open-ended and we believe that there needs to be some additional detail set out in the licence in terms of the process that the licensee is required to follow in order to have satisfied this licence obligation.

In particular, we believe that there needs to be an explicit requirement on Ofgem to provide clear and sufficiently detailed instructions to the licensee before they can raise a modification proposal in line with Ofgem's direction; the timetable for the licensee to comply with Ofgem's direction only to begin once the licensee has confirmed to Ofgem that they fully understand Ofgem's instructions; and a clause setting out what constitutes compliance with this licence obligation. We have suggested some additional text to the original licence drafting in the DN Gas Transporter Licence, Standard Special Condition A11, paragraph 15C (a) below (in bold italics):

“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.”

viii) Paragraph 15E(c) states that an appeal must not be brought for reasons that are trivial, vexatious or have no reasonable prospect of success. We do not believe that it is fair to prevent a party from appealing simply because it has no reasonable prospect of success – this prejudices the outcome of any appeal and, in our view, is inherently unfair.

x) Paragraph 20A (a) and (b) – we understand the rationale for this paragraph but, in our view, as currently drafted the clause is too wide-ranging and could be open to interpretation. We therefore believe that the term “approved” should be inserted into both paragraphs (a) and (b) in front of the term “changes”. This would clarify the drafting and the obligations to be placed on licensees.

xi) In the definition of ‘relevant objectives’, sub-paragraph (i) should refer to UNC charging methodologies rather than just charging methodologies.

xii) In the definition of ‘significant code review phase 1’, should paragraph (ii) refer to 15C(b) rather than 15B(b)?

Standard Special Condition A12: Joint Office Governance Arrangements

Paragraph 1(a)(i) should refer to “Standard Special Condition A11” and not “Special Standard Condition A11”.

Electricity Transmission Licence

Question 21

We fully support opening up the Transmission charging methodologies to change proposals by network users and customers and doing this by incorporating the charging methodologies into the relevant industry codes. We therefore welcome Ofgem’s decision in relation to charging methodologies.

However, we also firmly believe that in opening up the charging methodologies, the integrity of NWOs’ price control settlements must be protected in order to avoid windfall gains/losses to NWOs. For example, modification proposals seeking to change the boundary between use of system allowed revenue and the customer contribution element of connections charges would very likely require a re-opening of the price control settlement mid-price control. The potential for this to happen would significantly increase the regulatory risk faced by NWOs.

We believe that this risk could be effectively managed by Ofgem when assessing charging methodology modification proposals that would have a material impact on licensee cashflow and/or price control settlement. That is, where such a modification proposal is identified and if Ofgem are minded to approve, they could stipulate an implementation date in line with the next price control period. Alternatively, an earlier implementation date could be agreed subject to Ofgem committing to agree appropriate compensation / recouping of monies from the relevant licensee(s) in the next price control period.

To this end, we believe that the following wording (in bold) should be inserted into Condition C10 Connection and Use of System Code (CUSC) of the Electricity Transmission Licence:

“1. a. the efficient discharge by the licensee of the obligations imposed upon it under the Act and by this licence ***taking into account the revenue restriction provisions set out in the relevant special conditions of this licence***; and”

We believe that the above addition to the objectives set out in the licence would help to mitigate the above regulatory risk.

NTS Gas Transporter Licence

Question 12

i) For the same reasons as stated above regarding the Electricity Transmission Licence, we believe that the following wording (in bold) should be inserted into Standard Condition 4B Connection Charging Methodology of the NTS Gas Transporter Licence:

“5. a. compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by this licence ***taking into account the revenue restriction provisions set out in the relevant special conditions of this licence***;”

We believe that the above addition to the relevant objectives set out in the licence would help to mitigate the above regulatory risk.

Questions 7 and 20

ii) Standard Special Condition A11, Paragraph 6 d (ii) states that the panel's composition shall include *"a consumer representative (appointed by the National Consumer Council or any successor body [and any other consumer representative as may be appointed by the Authority]."*

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. We therefore believe that the text in square brackets and underlined above should be deleted and Ofgem should not have the power to appoint any other consumer representative with an associated vote on the panel.