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Dear Abid,

### **Open Letter Consultation: Potential Significant Code Reviews (SCRs)**

Thank you for the opportunity to comment on the proposals set out in the above consultation letter. We have done so under the headings set out below.

#### **General Comments**

We believe that it is essential that a process is put in place to ensure that SCRs are undertaken on a prioritised and proportionate basis and that they do not become unduly frequent and onerous. Such an approach will ensure cost effectiveness and a proportionate regulatory burden in line with the objectives of Ofgem's Code Governance Review. Importantly, it will also ensure that the resource burden (to both industry and Ofgem) and potentially significant industry change are managed smoothly. These benefits are clearly in the interests of all market participants, including new entrants and smaller parties.

The above was raised by industry early in the code governance review process and in response Ofgem stated:

*"It will be important to ensure that Major Policy Reviews are undertaken on a proportionate basis. We consider that Major Policy Reviews should only be used in limited circumstances where there are significant policy issues present and, as set out in Chapter 3, based on our current experience and knowledge we would not intend to initiate more than 1 or 2 such reviews a year."*<sup>1</sup>

Ofgem's commitment to launching only one or two SCRs in any one year is repeated in its final proposals of the code governance review and in the SCR guidance published alongside this consultation letter.

Against this background, therefore, we are very concerned to note that Ofgem is proposing to launch three SCR projects at the end of 2010 to run concurrently throughout 2011. This appears to run directly contrary to the undertakings given to industry by Ofgem throughout the code governance review consultation process and the principles of Better Regulation.

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<sup>1</sup> Ofgem, "Code Governance Review: Major Policy Reviews and Self Governance", 19/12/08

Moreover, the code modifications necessary to implement the licence changes giving effect to the SCR process will only be in place by the end of this year and have been progressed on a very tight timescale. As such, it is likely that some tweaks may be required to ensure that the SCR process runs smoothly when it is first used.

We would therefore urge Ofgem to launch only one SCR at the end of this year and, if appropriate, launch a second SCR only once the first SCR is complete and any modifications to the industry codes are at least well advanced. This would allow industry processes to fully bed in and ensure effective prioritisation of resources.

In addition, we firmly believe that where a SCR is carried out that Ofgem should undertake, in every case, to complete a post-implementation evaluation on the SCR recommendations / directions. As part of this, clear targets and objectives should be set out within the SCR conclusions along with a clear commitment to undertake a post-implementation review within a given timeframe. This would represent best practice and would allow the effectiveness of the SCR process to be fully assessed.

### **3 Priority Areas Identified for SCRs**

#### **i) Electricity Cash-Out**

As stated in the consultation letter, following approval of BSC modification P217A Ofgem committed to undertaking a post-implementation review of the electricity cash-out arrangements in November 2010. The aim of this review is to better understand the effects of modification P217A on cash-out prices and determine whether further changes are necessary.

We do not believe that it would be appropriate to launch an SCR, which is designed to facilitate complex and significant changes to the industry codes, in place of the post-implementation review. A post-implementation review is entirely separate to a SCR. Indeed, given the substantive nature of SCRs, each should be the subject of a post implementation review in their own right. To ‘amalgamate’ or ‘substitute’ a SCR for a post implementation review would effectively pre-judge the outcome of such a review.

Rather, in our view, Ofgem should undertake a post-implementation review of P217A in November 2010 (as already committed to) and the findings of this review should then determine whether there is a need for a SCR, an individual modification proposal or indeed no further action. This would also allow any required work in this area to be progressed in line with the Government’s appraisal of the electricity market (which Ofgem recognise could have significant implications for the design and functioning of the cash-out arrangements in GB).

In our view, there is no major identified problem with the existing electricity cash-out arrangements and we believe that this will be confirmed by the outcome of the post-implementation review of P217A.

## ii) Gas Security of Supply

We do not agree with Ofgem's view that there is a need for a SCR to review gas security of supply issues and in particular, the gas emergency cash-out arrangements. The gas emergency arrangements have undergone a number of relatively recent changes. The launch of a SCR would increase regulatory and price uncertainty which we believe would detract from the ultimate aim of attracting more gas to the UK in emergency situations.

In addition, we would not support further changes to the cash-out arrangements and in particular, we would be opposed to the implementation of a dynamic cash-out price in a gas deficit emergency. We believe that such a move would lead to significantly higher prices on the basis of a relatively small volume of gas which would greatly increase the risk to large and small industry participants alike.

## iii) Smart Metering Impact on Wider Industry Processes

Ofgem state that the SCR process can be used to develop, where appropriate, wider code changes in parallel with the work of the Smart Metering Implementation Programme (SMIP). We agree that there may be a role for a SCR as part of the smart metering roll out. However, we do not believe that the end of the year is the right time to launch a SCR on smart metering.

The SMIP is considering all issues concerning the roll out of smart metering, including both the interim and permanent arrangements via existing (and possibly new) industry codes. To run a SCR in parallel with the SMIP would complicate the existing programme and possibly lead to duplication of effort.

Rather, we believe that a SCR may be appropriate some time in the future (to be determined by the outcomes from SMIP) as a means of co-ordinating code changes expeditiously and managing cross-code issues. We do not therefore believe that a SCR on smart metering should be launched in 2011.

## **Transmission Charging Arrangements**

The consultation states that Ofgem is currently considering whether the transmission charging arrangements need to be reviewed through a SCR. We welcome Ofgem's recent announcement regarding the launch of Project TransmiT and we intend to engage fully in this project. Instead of the above three areas highlighted by Ofgem, we firmly believe that priority should be given to the timely delivery of project TransmiT (possibly via a SCR at the implementation stage).

## **Conclusion**

In conclusion, therefore, we would strongly urge Ofgem to prioritise the SCR topics with a view to launching only one SCR at the end of 2010 and, if appropriate, a second once the first SCR is complete. This would ensure a proportionate regulatory burden in line with the principles of Better Regulation and would also be consistent with the undertakings given to industry by Ofgem throughout the Code Governance Review process.



In terms of the three potential SCRs proposed by Ofgem, we do not support a SCR on gas security of supply issues and in particular the emergency gas cash-out arrangements as we believe that this would increase price and regulatory uncertainty to the overall detriment of market stability. Similarly, we do not believe that a SCR on the electricity cash-out arrangements is necessary. Smart metering may be appropriate in the future (possibly 2012) but this should be determined by the outcomes of the SMIP. Rather, we believe that priority should be given to the timely delivery of project TransmiT.

I hope that the above comments are useful. If you would like to discuss any of the above in more detail, please do not hesitate to contact me.

Yours sincerely,

Rhona McLaren  
Regulation Manager