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Dear Mark

Guidance on Ofgem's Approach to Conducting Impact Assessments

National Grid plc welcomes the opportunity to comment on the consultation on the Guidance on Ofgem's Approach to Conducting Impact Assessments consultation. This response is on behalf of National Grid Group plc and is not confidential.

Overall we consider that Ofgem's proposals represent a useful clarification of the process that it proposes to use. The approach proposed appears to be pragmatic and incorporates the features we would expect to be present. However there are some areas where further detail or clarity would be welcomed.

We consider that it will be important that there is no scope for material differences in the objectives which we are required to have regard to when assessing CUSC, Network Code, and other industry code modifications, and those Ofgem use when undertaking Impact Assessments (IAs). Indeed, further clarity on the interrelationship between these processes assessing similar objectives would be welcomed.

The Energy Bill that is currently progressing through Parliament proposes the development of an Energy Strategy and Policy Statement that will set out the Government's objectives / strategy in relation to energy policy. Presumably this could have a significant bearing on the criteria against which an IA is undertaken. However the consultation does not address the potential implications of this piece of legislation. This may be because Ofgem considers there is not yet sufficient clarity over the likely content of such a statement but, once the Bill has been passed, further consideration will need to be given to how Ofgem's guidance on IAs will be modified to addresses the content of any Energy Strategy and Policy Statement once implemented.

We consider that it would be helpful to set out the principles which Ofgem intend to adopt in relation to commercially sensitive information in their Impact Assessments in more detail.

We also believe that it is essential to have clarity regarding the basis on which IAs are undertaken given the scope for misalignment of EU and UK legislation. It is for instance possible that a particular proposal under consideration may have positive benefits for consumers when assessed on a regional or EU wide basis, but which may offer no benefits for GB consumers. Given the wider EU focus required by the Third Package we would welcome clarity regarding the basis of assessment where GB and EU benefits may differ.

We have addressed the questions raised by Ofgem in this consultation in an attachment to this letter. If you would like to discuss any of the points we have raised or have any questions regarding them then in the first instance please contact Andy Balkwill (andy.balkwill@uk.ngrid.com 01926 655 988).

Yours sincerely

[by e-mail]

Andy Balkwill
Regulatory Policy Manager

Consultation Questions

Question 1: *We are proposing to revise the structure of the guidance to place greater emphasis on Impact Assessment (IA) as a continuous, iterative process. Do you agree with our approach / emphasis?*

As policy develops and further information comes to light it is important that any process used to assess a particular proposal has the flexibility to respond to that new information and to changes in facts. Therefore, while we agree with the general intention behind this proposal we note the following points:

1. There is a potential risk that Ofgem's commitment to a continuous process could be subject to gaming. For example, opponents of a particular proposal could deliberately withhold new information until late in the process of developing the policy / code change concerned. The emergence of this new information might then be used to request a further IA to be carried out. While such a delay may only be a matter of months this could be sufficient to delay implementation until the following year¹ and so its impact could be significant.
2. We consider that there are limitations to an iterative process, particularly where modelling is used. In our experience, assessments can only be iterative to a point, at some stage this will need to be finalised, particularly where hard data assumptions are required and need to be locked down in order to produce modelling outputs. This should be clarified in the revised guidance.

Question 2: *Our proposed approach to assessing impact, costs and benefits is to develop an iteration of options between three aspects. These are: monetised, aggregate cost-benefit analysis; distributional effects; and long-term, hard-to-monetise considerations. These assessments are informed by a consideration of our principal objective to protect consumers (existing and future) and our other statutory and EU duties, including considerations of competition (EU and domestic). Do you agree with our approach to assessing impacts? We welcome any views on this approach, and the specific content within each category.*

1. This question states Ofgem's focus will be "...informed by a consideration of our principal objective to protect consumers (existing and future) and [Ofgem's] other statutory and EU duties, including considerations of competition (EU and domestic)....". Our concern is around how these objectives and duties interface with the objectives which we and industry participants are required to have regard to in the CUSC and other industry framework modification processes. While the two are related they are not exactly the same and so we feel it is important that the matters which Ofgem has regard to when conducting an IA are consistent with those used by stakeholders involved in the industry framework modification processes.
2. In order to avoid wasted effort it would appear sensible to ensure that there is a clear delineation between the matters to be considered in the industry code modification process and in the IA – otherwise the same issues are liable to be assessed twice against the same criteria.
3. We suggest that the IA approach should explicitly be designed to address all Ofgem's duties as set out in the Acts (rather than the summary of selected objectives and considerations as set out in the proposed guidance document). For instance a robust IA would be one way of addressing the requirement in Section 3A (1C) "Before deciding to carry out functions ... in a particular manner with a view to promoting competition²". This requirement does not at present seem to be reflected in the proposed guidance.

¹ some proposals may be intended to be address issues anticipated in a forthcoming season (for example Winter), or by 1 April to coincide with the start of the charging year. A delay of a month or two could easily mean that the proposal (if approved) could not be implemented in time to meet the perceived driver behind its implementation.

² And the equivalent section in the Gas Act

4. In relation to the reference to EU duties, we note that greater integration with Europe raises fundamental questions regarding the obligations placed on us by domestic legislation such as Section 9(2) of the Electricity Act 1989 which requires us to "...to develop and maintain an efficient, co-ordinated and economical system of electricity transmission...". Since European law takes precedence to UK law we need to be conscious of the way our obligations under the Electricity and Gas Acts and our licences need to be interpreted in order to be consistent with the policy enshrined in Electricity and Gas Directives and the rules set out in the Electricity and Gas Regulation³.
5. Arguably, changes to GB frameworks in response to EU market integration (or other policy developments requiring an IA) need to be assessed on the basis that they offer the most economic and efficient outcome and deliver the highest social welfare for consumers in the EU as a whole. However, we recognise that the development of a single energy market has many facets and views will often differ over who benefits from a particular development and therefore whether it is in GB consumers interests or not. This is reflected for example in the range of responses in relation to CMP 201. It will therefore be important for all parties to understand clearly the basis on which the assessment of any proposed policy development or framework modification proposal is undertaken. Given the primacy of EU legislation in this area, it would, in the longer term, be helpful to remove the scope for conflict or confusion between EU and national legislation by clarifying the obligations in the Electricity Act and Gas Act. In the interim greater clarity from Ofgem regarding the balancing of domestic and EU legislative obligations would be welcome.

Question 3: *We have interpreted our duty to have regard to sustainable development by considering a mid-term stress and security assessment and a long-term natural asset and greenhouse gas assessment. For more detail on this approach, please see our recent discussion paper "Strengthening strategic and sustainability considerations in Ofgem decision making" (June 2012). Do you agree with our approach to considering long-term, complex and hard-to-monetise issues? We welcome any views on this approach.*

We have no comments on this section.

Question 4: *Are there any other substantive changes that we should consider incorporating in the guidance, as appropriate to our statutory duties and functions?*

Range of options – the proposed guidance document does not make clear whether Ofgem's IAs will set out the range of scenarios against which the impact of the proposal will be assessed and how these compare against each other under the various relevant criteria. This would seem to be desirable and helpful in promoting the transparency of Ofgem's decision making.

Timing – Consideration of the optimum timing of a change, which would not just be the point in time which appears to maximise the cost/risk/benefit balance of a proposition, but that which also recognises the potential option value from deferring (or conceivably bringing forward) a decision may be worthwhile in certain circumstances. We therefore consider the approach to timing of changes (paragraphs at 3.16 and 3.17) is positive.

Consultation Timescales – We have some concerns in relation to the standard length of time allowed for consultation responses. We agree that a twelve week consultation period on issues that are expected to be of wide significance or interest is appropriate, but we are concerned that for consultation that are "urgent", considered to be "minor changes" by Ofgem, a four week consultation period is given. We have serious concerns that such a short consultation period may not allow us and other stakeholders a reasonable amount of time to respond and this will impair our ability to provide Ofgem with the information it requires in order to undertake analysis of costs and benefits as part of

³ Directive 2009/72/EC and 2009/73/EC and Regulations 714/2009 and 715/2009

Attachment: Guidance on Ofgem's Approach to Conducting Impact Assessments

the IA process. Further, if the categorisations of changes as "urgent" or "minor change" is to be used to justify a substantially shortened consultation then we consider that the criteria for such categorisations should be defined. Failure to adequately plan or anticipate for a change should not be sufficient reason to class a change as "urgent" and therefore apply the associated curtailed IA duration.

We recognise that there are times when due to a regulatory or statutory requirement or some other external driver that a shorter response time may be unavoidable. However, this should be the exception and clearly justified.

In considering the risk and uncertainties (paragraph 3.20) we would welcome further clarity on how these will be measured. Is it Ofgem's intention to use a conventional "impact" and "likelihood" approach? How are the impacts assessed given that in some cases they may be reputational in nature rather than financial?

We consider that transparency would be gained if the full list of considerations identified in 3.36 was set out in any IA. The same applies in respect of the longer term sustainability considerations referred to in 3.37. Whilst these will inevitably evolve and so can never be fixed, it would be useful for the known considerations to be identified in the guidance and for future considerations (such as those emerging from the Strategy and Policy Statement referred to above) to be recognised in the guidance to provide for future flexibility.

Ofgem's proposals do not explain how it will consider or recognise the impact of their decisions on investors. We recognise that in many cases Ofgem's proposals will not have a material impact on investors but there will be some cases where they do, and so this issue needs to be addressed. The Electricity Act 1989 and the Gas Act 1986 require the Authority to have regard to the need to secure that licence holders can finance their obligations. Ofgem therefore is required to assess the impact of its proposals on investors because of their role in financing Licence holders. Subject to considerations of commercial confidentiality we believe that this assessment should be undertaken as part of the IA so that all issues of relevance can be considered together.

The Energy Bill proposes the development of an Energy Strategy Policy Statement that will set out the government's objectives / strategy in relation to energy. Presumably this could have a significant bearing on the criteria against which an IA is assessed; however we note no mention is made of this piece of legislation or its potential implications.