E.ON UK plc
Westwood Way
Westwood Business Park
Coventry
CV4 8LG
eon-uk.com

Paul Jones
024 76 183 383

paul.jones@eon-uk.com

Maxine Frerk
Senior Partner – Smarter Grids & Governance
Ofgem
9 Millbank
London
SW1P 3GE

26 June, 2015

Dear Maxine,

Further review of industry code governance

Thank you for the opportunity to respond to your open letter of 15 May on the above issue. This response is made on behalf of E.ON's businesses operating in the GB market. In your letter you raise a number of issues which you believe may be undermining the effectiveness of current code governance to respond to the challenges and change affecting the gas and electricity markets now and into the future, and ask for views on how they may be improved.

We have always been keen to ensure that code governance arrangements work as efficiently and fairly as possible, and cannot provide a competitive advantage to any particular party or group of parties. Governance arrangements are rarely something that can be put in place once and then forgotten about. They constantly have to evolve in response to lessons learned through their operation over time and to cater for changing circumstances.

This is as true now as ever. Therefore, we agree that it would be worthwhile to review the current governance arrangements, including assessing how effective the changes which were introduced as part of the last code review have been, with a view to making improvements where necessary.

E.ON UK plc

Registered in
England and Wales
No 2366970

Registered Office:
Westwood Way
Westwood Business Park
Coventry CV4 8LG

We do not believe that the case has been made for wholesale reform of the arrangements. We note that whilst some parties have levelled criticism at the code modification processes and perhaps perceive them as a barrier to entry, no one has articulated a radical alternative solution. Indeed, we believe that this would be counterproductive by diverting resource away from progressing changes which are required in the market to respond to future challenges and circumstances.

On a process point, we are interested in understanding how the review would interact with the Competition and Market Authority's (CMA) current investigation of the market. The open letter seeks responses from parties just before the CMA is due to provide its initial findings on its own investigations of the code governance arrangements. We assume that Ofgem will ensure that any review of the arrangements is undertaken in such a manner so that it does not interfere with the CMA's own investigations and its ability to make recommendations. For instance, we are uncertain of what would happen should Ofgem decide that an area of the governance arrangements needs to be addressed and the CMA has concluded that it does not. Some clarity on how the two processes will interact would be helpful.

Our responses on the particular issues raised in the letter are as follows.

Question 1: Do you consider the governance changes introduced under CGR and CGR2 have been effective in improving the code governance arrangements. In particular considering the efficiency and effectiveness of code change, the ability for large scale reform to be implemented, and the accessibility of the arrangements for smaller/newer industry participants and consumer representatives?

In our view the arrangements introduced under the Code Governance Review have generally be positive. Certain aspects, such as the introduction of the Code Administration Code of Practice (CACoP), have been helpful in introducing greater consistency in administration across codes, including the sharing of best practice. We note that not all aspects of the CACoP have been adopted across all codes. For instance, the Balancing and Settlement Code does not currently allow for multiple alternative modification proposals to be developed. This is perhaps something which should be addressed.

Code Administrators have improved at providing support to parties, particularly smaller parties, with raising and progressing modifications by being a "critical friend". This helps to ensure that proposals are raised that are of suitable quality and free of obvious issues that may prevent their efficient development and assessment in the code modification process.

Independent chairs for panels seem to have been successful where they have been appointed. Previous panel chairs have often sought to act independently, even though they were employed by an industry party such as the system operator. However, a fully independent chair instils more confidence that meetings will be chaired impartially and can also bring a different perspective to panel meetings from different industries and markets.

The self-governance arrangements have also been helpful in ensuring that low impact and housekeeping type modifications can be efficiently progressed and implemented without the need for a formal decision from the Authority. In practice, it has been a challenge in some instances for panels to assess exactly when it is appropriate for modifications to be progressed in the self-governance process, as to some extent they have to second guess what Ofgem's perspective would be, as it holds the ability to veto their decision. However, generally panels have worked well with Ofgem to identify the most appropriate route for proposals and we would expect this process to become more efficient as they gain more experience of this.

We have mixed views of the Significant Code Review (SCR) arrangements. Our experience is that both industry and Ofgem have engaged positively in the process whenever a SCR has been raised by Ofgem. It has taken a long time to carry out the SCRs raised thus far, as the information in your open letter shows. To a large extent this illustrates the magnitude and complexity of the issues that have been explored and the changes which have been raised as a result. We do not believe that this has resulted from the design of the arrangements themselves nor how the industry has participated in them.

However, our views of the SCRs progressed so far is that they have not delivered significant benefits to customers, partially as they have focussed on the wrong issues, such as wholesale markets charging issues. This has not resulted in clear benefits to customers, but has instead conveyed a financial or competitive advantage in the wholesale market to certain market participants, often large existing players, at the expense of other parties.

We understand that Ofgem is interested at this stage in views on the SCR process itself rather than the decisions that have been made as a result. However, the key element of the SCR process was that it introduced the concept of Ofgem instigating and driving forward the change process, rather than adjudicating on changes raised by industry parties. Therefore, a critical element to the process is the initial choices that are made when deciding which issues should be considered under a SCR.

We cover the SCR process more in our answer to question 2 below.

Question 2: Do you agree that there is a need to consider further reforms to the industry code governance arrangements? If so, what issues do you consider should be addressed, and what possible solutions do you identify?

The open letter mentions the SCRs that have been pursued so far and notes that they have taken longer than was perhaps anticipated. We agree, but believe that this was not necessarily down to the process itself, but down to the complexity of the issues being addressed and the sometimes controversial nature of what was being proposed. This meant that a wide variety of views had to be considered on the large number of individual elements which made up the overall proposals for change.

We note in paragraph 2.9 that it is questioned whether the level of industry involvement and engagement may have had a bearing on the time it took. We assume that this is

referring to the sheer volume of responses and views Ofgem has had to consider as a result of the level of engagement. Our experience is that the SCRs have attracted a high degree of industry engagement and clearly this will impact on the time it takes for Ofgem to make an informed decision taking into account all views expressed.

We believe that the proportion of time that these reviews have spent in the formal code change process has been relatively short, particularly considering the breadth and complexity of the changes being developed and assessed. For instance, Project Transmit took 3 years and 10 months, from the time it was first launched in September 2010 to the Ofgem implementation decision on the CUSC modification which was raised as a result. The formal SCR process was shorter taking 3 years from the launch in July 2011. The time spent assessing the modification in the code process, from the proposal being raised to the panel recommendation, was just under 1 year. The Electricity Balancing Significant Code Review (EBSCR) took 2 years and 8 months to reach the final decision. Of this, 10 months was spent in the code process itself.

In paragraph 2.10 it is noted that the SCR process has required a significant amount of consultation with stakeholders by Ofgem and the question is asked of whether this could be streamlined at all. We are uncertain as to whether the amount of consultation could be reduced from that undertaken previously. The SCR process is designed to review a wide section of, and implement significant change in, the industry arrangements. Therefore, this requires an appropriate level of consultation if stakeholder views are to be fully considered as part of the process and to inform any decisions taken by Ofgem as a result. If Ofgem failed to undertake sufficient consultation, its subsequent decisions could be less informed and ultimately open to challenge.

The suggestion is made in paragraph 2.11 that Ofgem could take a backstop power to draft code modifications arising from a SCR. We can see merit in this, but would suggest that perhaps Ofgem should consider drafting and raising all modifications arising from SCRs. At present, by requiring a licensee to draft and raise a proposal through the SCR direction, the affected licensee is forced to become the advocate for the change, whether it supports the proposal or not. This means that it is effectively precluded from providing its own views into the assessment process. Therefore, a double risk arises. Firstly, the proposer of the modification may not be as fully committed to advocating its implementation as might be the case if Ofgem raised it. Secondly, Ofgem could miss out on a valuable alternative view in the assessment process which would further inform its final decision.

In paragraph 2.12 it is suggested that perhaps Ofgem should be able to direct code modification timescales in a similar manner to which it can for modifications required to implement European legislation. Ofgem currently has a high degree of influence over the code modification timescales as, for a number of codes, panels are only able to extend timescales for assessing modifications with Ofgem's permission. Of course, this requires Ofgem to be fully engaged in the code process and the relevant panels where timescales are considered.

Extending Ofgem's powers in this matter would effectively seem to be a small change from this position. Of course, if Ofgem were to be more formally responsible for managing timescales it would need to invest the necessary resources and expertise in

fully understanding the codes and the market in sufficient detail to understand how much time will be needed to effectively develop and assess each modification. It will also need to be able to fully understand potential reasons for extending the timescales, which may arise as proposals are being assessed.

Paragraphs 4.3 and 4.4 refer to the "critical friend" role that code administrators provide to parties, particularly smaller companies, and questions whether more could be done in this respect. It appears that some code administrators have taken this role very seriously and have been very helpful with parties seeking to raise changes to, or understand other aspects of, the codes they administer. It should be noted that all parties currently find the amount of legal, regulatory and policy change a challenge to manage and this is not confined to small parties. Therefore, continued assistance from code administrators is as important as ever and it would seem right to explore whether this can be done more effectively.

Paragraphs 4.5 to 4.7 relate to the Code Administration Code of Practice and questions whether more can be done to help smaller parties in particular with engaging in the code change processes. Specifically, the issue of differences between codes is mentioned as something which may prove a barrier to parties trying to engage with the code processes. This on the face of it is a valid point. If all codes had similar processes for raising and pursuing change then all parties would find it easier to engage. Some of this difference of approach has arisen as each code has been created in isolation from the others and at different times. Therefore, when the governance arrangements were created they reflected what was considered the most appropriate solution at that time.

However, it should be recognised that different codes are set up to reflect the different nature of the issues that they address and the relationship between signatories which arise as a result. Nevertheless, there would be some merit in exploring whether code processes could be brought together more and share more elements of best practice. One area where E.ON and a number of industry parties have been active in this sense is the work to bring the Grid Code under more open industry governance.

We also agree that it would be beneficial to ensure that changes which require modification proposals across a number of codes are better coordinated. We support the work that the code administrators have been doing in this respect, for instance with the proposed creation of a 13th principle in the CACoP to support cross code coordinated working.

Paragraph 4.7 of the letter mentions the amount of code change which is progressed and considers whether something can be done to manage the change process better and the timings of when changes are proposed. Two approaches are suggested. The first is a more strategic approach from panels, such as a forward work plan for the year. The second is specifying a window for within which changes can be raised. Currently, all parties can propose changes whenever they wish and these have to be considered by the relevant panel and progressed through the code modification process, taking into account the resource available to do so.

We would be wary of panels or Ofgem interfering in this right, except of course when a change falls within the scope of an active SCR. Fettering the ability of parties to raise

changes when they need to may not work in the best interests of fostering greater innovation into the market. In addition, introducing a window for raising changes would seem to work to slow down the consideration of changes. A party may wish to raise a change now, but have to wait 6 months for the window to open and the modification process to start. It also runs the risk of storing up modifications to be considered all at once when the window allows. At present, peaks and troughs in code modification work can be experienced, but the ability for parties to raise changes throughout the year evens this out to some extent. We would also be wary of any solutions which require panels or Ofgem to prioritise some modifications over others.

In paragraph 4.8 potential concerns are raised about modification panels and work groups being dominated by larger parties, mainly because smaller parties are less able to resource them. There are a number of issues to consider here. In terms of working groups, then this is undoubtedly correct although we have noticed that when issues are of particular importance to smaller parties, then they do manage to provide the resource to attend meetings.

However, the picture is not clear cut. For instance, support or opposition for changes doesn't generally depend on whether a party is small or large. For instance, the changes to imbalance pricing implemented under the Electricity Balancing SCR were opposed by a number of small suppliers and larger companies alike. Additionally, the effects on smaller parties are often considered as part of the assessment of a modification on competition, and these issues are often flagged up by larger companies or network operators.

Companies do benefit from participating in working groups and providing people to sit on code panels. It is a useful way of understanding the modifications that are being processed and their potential impact on the market. However, it also provides free resource and expertise to the code process. A large proportion of the role of panels is to oversee the processing of modifications and therefore is largely administrative. Panels do make recommendations on whether modifications should be implemented or not, but ultimately Ofgem makes this decision. The panel recommendation purely determines whether or not a party is able to appeal that decision to the CMA.

At present E.ON provides representation to around 11 panels and code boards. We estimate that this amounts to around 160 person days of resource per annum. If we were required to reduce our representation as a result of the above concerns we would clearly do so. However, this resource would need to be found from elsewhere, perhaps at additional cost.

Another approach which is suggested is a requirement for panel members to act independently of their company's interests across all codes. It is noted that certain codes already require this. We would not be opposed to this being added as a requirement to those codes which currently do not have this feature.

Another issue which is raised is that some codes do not have panel recommendations, but rely on voting change boards. The concern is that this, although democratic, may not result in the most effective recommendation in to meet the objectives of the code.

We believe that these change boards can have real merits, particularly in allowing smaller parties to participate in the recommendation process. A model which seems to work well is that for the DCUSA. This has an open voting process which takes place by email, so that parties do not have to attend a physical meeting each month to make their recommendation. It has a one party one vote principle so all parties can take part. The voting is split into constituencies, so a majority of each constituency has to agree to a change for it to be recommended, which allows a balance of views from different perspectives. Voting in this manner also allows a large number of changes to be considered in a reasonably short period of time.

It should be reiterated however, that none of the current arrangements prevent a modification from proceeding to Ofgem for a decision. A key principle of the code which we have always strongly supported is that the proposer of a modification retains ownership of its preferred solution. The above arrangements simply affect what recommendation is made to Ofgem. It does not prevent Ofgem from implementing that solution if it disagrees with the panel recommendation.

As we mention above in our response to question 1, we believe that the introduction of independent chairs has generally been a positive step. Other codes may benefit from their introduction, although it should be noted that this introduces an additional cost to administering the code. For some codes which already operate on low budgets, this may be seen as an unnecessary expense. Additionally, code administrators, perhaps assisted by panels, need to undertake a sufficiently robust recruitment process to ensure that the right appointment is made. Nevertheless, we would support this being considered further.

The letter also seeks views on how consumer interests can be better represented in the code process. To a large extent suppliers seek to represent the interests of their customers in the code process, by articulating the effect a modification will have on customers and competition in general. Additionally, many panels have an appointed consumer member who is able to vote on code recommendations.

One suggestion is whether there should be a more formal requirement on working groups and panels to consider the potential impacts of modifications on customers. We would fully support this. The customer should be at the heart of what the industry does, not only for those parties operating in the competitive retail market, but wholesale participants and network operators alike. One way to implement this, with reasonably little effort, would be for this requirement to be added to the standard Terms of Reference that each code has for working groups. Alternatively, if more formality is required, it could form the basis for an additional principle for the CACoP or indeed a new code objective, although we would note that the latter is likely to require licence changes.

Finally, the letter considers whether charging modification processes would benefit from better management. In particular, a potential pre-modification process is suggested where issues could be considered before entering the code process. Currently, the transmission and distribution charging arrangements include charging forums where interested parties and experts discuss the effectiveness of current arrangements, any changes being progressed and the potential for further change. We believe that these are reasonably effective in allowing issues to be explored and developed before parties raise them as formal modifications.

We would be reluctant for this to be a formal requirement for all change proposals. Some changes are already well developed by proposers and ready for assessment. The benefit of launching them into the change process rather than a pre modification discussion group is that formal timescales and processes are set for the assessment of the modification proposal, ensuring that it can be implemented in as timely a manner as possible. We are concerned that the pre-modification process would not be subject to these same disciplines and would simply add delay.

Question 3: In addition to a post implementation review of our CGR reforms and potential changes discussed in this letter, are there any other areas of industry code governance that should be considered in this review?

We have no further views to contribute over and above those above thank you.

I hope that you find the above views helpful in deciding what you would wish to form part of any review. Should you wish to discuss any of these issues further, please contact me in the first instance.

Yours sincerely

Paul Jones
Head of Market Development