

Gas and electricity licensees,  
industry participants, consumer  
representatives, code panel  
chairs, code administrators and  
other interested parties

Email: [industrycodes@ofgem.gov.uk](mailto:industrycodes@ofgem.gov.uk)

Date: 10 May 2016

Dear colleague,

### **Code Governance Review (Phase 3) Final Proposals – statutory consultation on licence modifications**

On 31 March 2016, we published our Code Governance Review (Phase 3) (CGR3) Final Proposals.<sup>1</sup> At the same time we also consulted on illustrative licence drafting that set out the changes to licence conditions that could give effect to our proposals.<sup>2</sup>

We received 15 responses to our consultation on the licence drafting, these are available on the Ofgem website. Of those respondents that commented on the specific questions we asked in the consultation all agreed that: the licence drafting would achieve the policy proposals set out in our CGR3 Final Proposals; the licence drafting would also facilitate the implementation of GC0086; and, that where the licence drafting differs between licence conditions, the substantive effect is materially the same.

Appendix 1 of this letter sets out our comments on the specific points raised in the responses we received, and the amendments to the licence drafting we have made in the light of those comments. The statutory notices that would give effect to the licence drafting are included in the Appendices to this letter, which are available as separate documents.

#### **Overview of proposed modifications**

<b>Affected code</b>	<b>Licence condition to be modified</b>	<b>Summary of proposed changes</b>
BSC	Electricity Transmission Licence SLC C3	Introduce Ofgem-led Significant Code Review (SCR) process; introduce ability for Ofgem to raise SCR modification proposals; make a housekeeping amendment to the applicable objectives
CUSC	Electricity Transmission Licence SLC C10 and C5	Introduce Ofgem-led SCR process; introduce ability for Ofgem to raise SCR modification proposals; make housekeeping amendments to the applicable objectives
STC	Electricity Transmission Licence SLC B12	Introduce Ofgem-led SCR process; introduce ability for Ofgem to raise SCR modification proposals; make a housekeeping amendment to the applicable objectives
DCUSA	Electricity Distribution Licence SLC 22 and 22A	Introduce Ofgem-led SCR process; introduce ability for Ofgem to raise SCR modification

<sup>1</sup> <https://www.ofgem.gov.uk/publications-and-updates/code-governance-review-phase-3-final-proposals>

<sup>2</sup> <https://www.ofgem.gov.uk/publications-and-updates/code-governance-review-phase-3-final-proposals-consultation-licence-modifications>

		proposals; add applicable charging methodology objective related to facilitating efficiency in code administration
MRA	Electricity Distribution Licence SLC 23	Introduce Ofgem-led SCR process; introduce ability for Ofgem to raise SCR modification proposals
Distribution Code	Electricity Distribution Licence SLC 21	Introduce Ofgem-led SCR process; introduce ability for Ofgem to raise SCR modification proposals; add applicable objective related to facilitating efficiency in code administration
Grid Code	Electricity Transmission Licence SLC C14	Introduce Ofgem-led SCR process; introduce ability for Ofgem to raise SCR modification proposals; facilitate introduction of open governance as per GC0086; add applicable objective related to facilitating efficiency in code administration
UNC	Gas Transporter Licence Standard Special Licence Condition A11	Introduce Ofgem-led SCR process; introduce ability for Ofgem to raise SCR modification proposals
iGT UNC	Gas Transporter Licence SLC 9	Introduce Ofgem-led SCR process; introduce ability for Ofgem to raise SCR modification proposals
SPAA	Gas Supply Licence SLC 30	Introduce Ofgem-led SCR process; introduce ability for Ofgem to raise SCR modification proposals

The statutory notices in respect of each licence to give effect to our Final Proposals are set out in the Appendices to this letter as follows:

Appendix	Licence	Relevant Industry Code
2	Electricity Transmission Licence	BSC, CUSC, STC, Grid Code
3	Electricity Distribution Licence	DCUSA, MRA, Distribution Code
4	Gas Transporter Licence (Standard Special Conditions)	UNC
5	Gas Transporter Licence (Standard Conditions)	iGT UNC
6	Gas Supply Licence	SPAA

Responses to these statutory notices should be received by 7 June 2016 and be sent to:

Marion Quinn  
Industry Codes & Licensing  
Ofgem  
9 Millbank  
London SW1P 3GE  
[industrycodes@ofgem.gov.uk](mailto:industrycodes@ofgem.gov.uk)

We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so that they can be placed easily on our website.

Yours faithfully,

**Lesley Nugent**  
**Head of Industry Codes and Licensing**

## Appendix 1 – Comments on consultation responses to Illustrative Licence Drafting in respect of CGR3 Final Proposals

On 31 March 2016, we consulted on illustrative drafting of the modifications that could be made in order to give effect to our final proposals. We received 15 responses to our Final Proposals licence drafting consultation. The responses we received are summarised below, alongside our comments.

Response	Ofgem's Comments
<p>If the Authority were to issue a direction for a modification proposal and any alternatives to be withdrawn, would it be possible for a relevant party to the code to take ownership of the modification?</p>	<p>The licence drafting provides the ability for the Authority to issue a 'backstop direction', requiring SCR modification proposals and any alternatives to be withdrawn. See, for example, paragraph 4G of the suggested licence drafting in SLC C3 of the electricity transmission licence in respect of the BSC.</p> <p>The effect of a 'backstop direction' is to re-start the SCR phase, and allow the Authority to consider whether to re-issue SCR conclusions and/or directions, or whether to begin the Ofgem-led end-to-end SCR process.</p> <p>Because the SCR phase re-commences when a 'backstop direction' is issued, the restrictions on making modification proposals as set out in licence come into effect. See, for example, paragraph 4B of SLC C3 of the electricity transmission licence. In consequence, it would not be possible for another party to take ownership of the withdrawn modification.</p> <p>We recognise that there was some lack of clarity regarding the operation of a 'backstop direction'. We have therefore amended the licence drafting to make clearer where the power to issue a 'backstop direction' resides and its effect on the SCR phase. We will also expand our draft SCR Guidance to provide further explanation regarding when such a direction would be issued and its effect.</p>
<p>The amendments to the definition of 'significant code review phase' are confusing, because there is a reference to the same provision in limb (a)(ii) and (b)(iv).</p>	<p>A number of respondents appeared unclear that an effect of a 'backstop direction' was to cause the SCR phase to recommence. Limb (a)(ii) of the definition of SCR phase therefore refers to the making of a backstop direction. In circumstances where either the SCR phase has recommenced by virtue of a backstop direction, or the SCR phase has continued by virtue of the Authority stating that it intends to carry out the Ofgem-led end-to-end SCR process, it is necessary to identify how the SCR phase ends. Limb (b)(iv) of the definition of SCR phase therefore identifies the relevant paragraph in the licence drafting that deals with the end of the SCR phase in these two circumstances. It is for this reason that limb (b)(iv) of the definition of SCR phase makes reference to a 'backstop direction'.</p> <p>As identified above, we recognise that there was some lack of clarity regarding the operation of a 'backstop direction'. We have amended the licence drafting to make it clear in the definition of SCR phase that reference is being made to a 'backstop direction'. We will also expand our draft SCR Guidance to provide further explanation about when the SCR phase commences and ends.</p>
<p>We have reservations about the Ofgem-led end-to-end</p>	<p>As set out in our Final Proposals, we consider that Ofgem leading an end-to end process would be particularly</p>

SCR process.	beneficial in situations involving complex SCRs that affect multiple codes. Under the present SCR regime, a direction issued by Ofgem may have its detail developed under the jurisdiction of the various affected code parties, leading to variations in the final modification proposals, both in content and timing, that are presented to the Authority for approval. The end-to-end process will allow a co-ordinated and consistent response to be developed.
It is unclear from the updated draft SCR Guidance what criteria Ofgem would use to decide which SCR option to use. The ability to move between SCR process options goes beyond what is currently being considered by the Competition and Markets Authority.	We recognise the concerns raised regarding the criteria that Ofgem would apply to determine which SCR process to use. We will review our draft SCR guidance on the circumstances in which it would be appropriate to use the Ofgem-led end-to-end process, and, in formulating our final guidance, we will take account of the CMA's proposed remedies.
The legal text should set out the criteria Ofgem would use to determine the options for the SCR process	We do not consider that the licence is the appropriate place to set out the criteria adopted by the Authority to determine which process to use. We have therefore drafted guidance to assist interested parties in understanding the process that the Authority would follow.
The panel should have an ongoing role throughout the SCR process in an Ofgem-led end-to-end SCR process.	We recognise the importance of the role that code panels play in the development and progress of modification proposals. As set out in our draft SCR guidance, we would expect to undertake consultation with all affected parties (code administrators, code owners, affected licensees and code parties) throughout the SCR process, and to work collaboratively with the industry, including panels where appropriate, in developing modifications.
There should be a licence amendment to the paragraph concerning self-governance. There should not be a need to submit a self-governance statement every time self-governance is used.	The respondent considered that the alternative of having a guidance document in place would better facilitate the BSC objective on promoting efficiency in administration. We agree that it would be helpful to have a guidance document in place, and (as set out in our Final Proposals) we consider that code administrators are well placed to lead work on this. In respect of the drafting of the paragraph, we note that there are currently different approaches under different codes regarding self-governance statements. We therefore consider that the code administrators should give further thought to the need (or not) for a statement and what consistent process should apply across all the codes. We could take forward a licence change at a later date if appropriate.
The reference to 'or members of the panel' should be deleted in SLC 22 and SLC 23 of the Electricity Distribution Licence.	We recognise that the current drafting does not reflect what happens in practice. However, as we set out in our Final Proposals, we have requested industry to review the current process, which may result in a change to the current practice. We therefore do not consider it appropriate to amend the current drafting at this time, given it may need to be amended further following the industry review.
In respect of SLC C3 of the electricity transmission licence, why is paragraph 4A 'without prejudice to paragraph 4E'?	Paragraph 4A of SLC C3 restricts the ability to make modification proposals during an SCR phase. Paragraph 4E provides the Authority with the power to develop, and submit to the panel, a modification proposal under the Authority-led end-to-end SCR process. This would occur during the SCR phase, hence why paragraph 4A is without

	prejudice to paragraph 4E.
In respect of SLC C3 of the electricity transmission licence, should paragraph 4C(ba) cross refer to paragraph 4H(b)?	Paragraph 4C(ba) cross-refers to paragraph 4(a) because it is this paragraph that provides the Authority with the power to make a modification proposal. Paragraph 4H(b) limits the Authority's power to make a modification proposal.
In respect of paragraph 4D of SLC C3 of the electricity transmission licence, it is very open ended as to how the Authority would proceed.	The Authority would act in accordance with its SCR Guidance. The Authority would not unduly delay in making a decision about how to proceed once it had either issued a backstop direction or had issued a statement that it was continuing the SCR phase.
In respect of SLC C3 of the electricity transmission licence, the process in paragraph 4F does not mirror paragraph 4(d)(i) – (iii).	The Authority would be able to make a direction for compliance with the modification procedures (etc.), even in respect of implementation of a modification reached through the Ofgem-led end-to-end SCR process.
In respect of SLC C14 of the electricity transmission licence (Grid Code), is it correct that the chairperson is appointed by the authority?	We agree that there is no requirement for any approval by the Authority of the Grid Code panel chairperson to be set out in the licence condition. We consider that the process for appointing the chairperson should be set out within the Grid Code itself. We have therefore amended the licence drafting to reflect this change.
In respect of SLC 21 of the electricity distribution licence (for the Distribution Code), paragraph 21.11B(ba) refers to a modification proposal being 'made'. Is this different to a modification proposal being raised?	The licence condition refers to a modification proposal being 'made' rather than 'raised' throughout the condition. This does not require the modification to have been decided upon or implemented, rather that the proposal itself has been made. However, we recognise that, in limb (c) of this paragraph, it should be made clear that statements by the Authority are 'issued' rather than 'made'. We have amended the licence drafting accordingly.
In respect of SLC 21 of the electricity distribution licence (for the Distribution Code), paragraph 21.11C(c) refers to the submission of a report. However, there may not be a report.	In circumstances where a backstop direction has been made and/or the Authority has commenced the Ofgem-led end-to-end SCR process, there will be a report in respect of the modification. An SCR must relate to a matter of particular significance, and thus the modification would be material.
In SLC 22 of the electricity distribution licence (in respect of DCUSA), it is not clear whether the end of paragraph 22.9E should have its own number.	This relates to a provision that is not being inserted into the condition, and so is not being consulted upon. However, the same wording is suggested for insertion in paragraph 22.9EC. This paragraph forms part of the condition and does not require its own paragraph number.
In SSC A11 of the gas transporter licence (in respect of the UNC), paragraph 15A(b) refers to a modification proposal made in accordance with paragraph 9(j). However, this paragraph refers to 'directions', rather than a modification proposal.	This is not a new provision and so is not being consulted upon. However, we hope it is of assistance to note that the word 'directions' is a defined term, which refers to the instructions to make a modification proposal.
In SSC A11 of the gas transporter licence (in respect of the UNC), the	This is correct. In paragraph 9(i), the words 'fall within the scope of paragraph 15CE' should have been underlined. In paragraph 9(j), the word 'which' should not be marked as

<p>new text to be inserted into paragraph 9(i) and 9(j) has not been marked up correctly.</p>	<p>deleted. We have amended the licence drafting accordingly.</p>
<p>In SSC A11 of the gas transporter licence (in respect of the UNC), paragraph 10(aa) should cross-refer to paragraph 15C(a), rather than paragraph 15C.</p>	<p>We recognise that the part of 15C that is of particular relevance in respect to 10(aa) is 15C(a), but we consider that the reference to the entire provision (15C) in this (and other similar conditions) captures this. We therefore do not propose to make this change at this time.</p>
<p>In SSC A11 of the gas transporter licence (in respect of the UNC), the drafting of paragraph 15C should make clear that any of the options specified can apply.</p>	<p>We have sought to modify the existing provision to as limited extent as possible. While we recognise that alternative drafting could be used, we consider that the proposed drafting makes clear that the options specified are alternatives.</p>
<p>In SSC A11 of the gas transporter licence (in respect of the UNC), paragraph 15CC(a)(i)(bb) introduces a new objective.</p>	<p>This provision does not introduce a new objective. Rather, it replicates the existing provision in paragraph 15(a)(iv)(bb).</p>
<p>The conditions are complex. Further, the new paragraph numbering is confusing. The drafting would benefit from restructuring and signposting.</p>	<p>We recognise that the conditions being modified are already complex, and that the amendments add to their complexity. We have sought to simplify the new paragraph numbering as much as possible. However, we do not consider that it is appropriate to engage in wholesale re-numbering or restructuring of each relevant condition at this stage.</p>
<p>The use of words and numbers to describe the length of time does not conform to the convention used elsewhere in the distribution licence.</p>	<p>The proposed amendments to the licence conditions are internally consistent with the drafting already in existence within that condition. For this reason, words and numbers are used to denote periods of time.</p>