



Mark Feather  
Director, Industry Codes and Licensing  
The Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE

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

22 January 2008

Dear Mark

### **Review of industry code governance**

We are writing to you in response to your open letter of 28 November 2007 setting out our initial views on the appropriateness and scope of this review.

As a major generator, shipper, supplier, electricity distributor and energy services company E.ON UK has an interest in all the codes referred to in your letter. Given the broad scope of our activities we are able to view the operation of these codes from a number of perspectives, not only as a user and network operator but also in relation to whether these codes assist us in meeting the needs of our customers. Indeed E.ON UK is itself one of the largest gas customers.

As the industry codes set out most of the common commercial and technical rules within which competitive GB energy markets work, it is important they are managed efficiently. These rules can directly or indirectly impact the cost and quality of service we are able to offer our customers. We therefore need to have the opportunity to participate actively in code developments and be confident that our views have been fairly considered as part of that process and in the final modification decision on proposed changes.

Ultimately we want a value for money, transparent change process that delivers consistent decisions of high quality within appropriate timescales. For us, this is about governance of the whole modification process. Ofgem has previously articulated 'principles of good governance' focusing on effectiveness, efficiency, transparency, participation, accountability and consistency during the development of the Supply Point Administration Agreement (SPAA). In approaching this review we consider that it would be helpful to re-visit these principles, and supplement them with the bulleted list of issues identified at the end of your letter. These could then be used as high level evaluation criteria for the review.

E.ON UK plc  
Registered in  
England and Wales  
No 2366970  
Registered Office:  
Westwood Way  
Westwood Business Park  
Coventry CV4 8LG

Overall we are not persuaded that there are fundamental weaknesses in the current structure or governance of industry codes, although we acknowledge that there may be scope, where best practice can be identified, for this to be adopted more widely. Adopting a 'one size fits all' approach, however, is in our view likely to be problematic as the purpose and operational context for each type of code can be significantly different. For example the Master Registration Agreement (MRA) is a multi-party agreement rather than a code mandated by a network business's licence; the Grid Code sets out highly technical rules which, even though there may be professional disagreements between Panel members, successfully relies on building consensus, and the System Operator Transmission Owner Code (STC) is not a 'user-facing' code.

It appears from Ofgem's letter that it does have concerns around the current governance of industry codes. We sense that this in part arises from the sheer volume and complexity of the proposed changes that Ofgem has to evaluate and make decisions on each year. This brings into focus an area that is not specifically highlighted by Ofgem in its initial scoping letter – that of whether the balance is right between the industry and Ofgem in terms of division of powers and functions on Code governance. Streamlining code modification processes and focusing resources on high impact issues<sup>1</sup> would offer the best way of improving the quality of these important decisions. By allowing more routine matters to be dealt with by the industry under a form of self-determination, without reference to Ofgem, (other than allowing parties perhaps to appeal a decision), would provide Ofgem with more time to focus its resources and expertise on those code changes that involve more fundamental change and where industry agreement cannot be achieved.

A limited self-determination model appears to work well under the Distribution Connection and Use of System Code Agreement (DCUSA). It is a model that could be adopted by other codes such as the Balancing and Settlement Code (BSC), the Uniform Network Code (UNC) and the Connection and Use of System Code (CUSC). At the very least it would seem to us that a unanimous or near unanimous<sup>2</sup> recommendation by a code Panel could become a binding decision, but with an appeal route to Ofgem. Ofgem has previously been supportive of more industry self-governance and stated<sup>3</sup> as part of the SPAA development:

*"In the longer term it is likely that SPAA will lessen Ofgem direct involvement in many aspects of gas industry governance. For instance, every change to Network Code, no matter how insignificant or patently beneficial, currently requires Ofgem's approval. Whilst this level of regulatory involvement ensures a high degree of accountability, it is perhaps no longer necessary in many instances."*

Turning now to those difficult, sometimes controversial decisions. We think it is right that affected parties and decision makers (whether customers, users, network businesses, Panels or Ofgem itself) should from time to time be unhappy with particular outcomes. In our view, if an organisation is consistently satisfied or dissatisfied with the process, it is probably not working properly. In our view, at the heart of good governance are checks and balances in the regime so that particular users, network businesses or, at the extreme, Ofgem are unable to use the modification process solely to meet their own organisational objectives.

---

<sup>1</sup> Those matters that profoundly affect the competitive market, involve material costs to individual code signatories and/or issues that (genuinely) require urgent attention.

<sup>2</sup> This was suggested as part of Powergen's BSC Modification proposal P129, but this approach critically depends on establishing a Panel that is able to reflect the diversity of industry and stakeholder views.

<sup>3</sup> Paragraph 1.19, Ofgem Gas Retail Governance, Further Consultation June 2003.

Ofgem rightly focuses on the concerns of small players. It is true that as a large vertically integrated player E.ON UK is better able to resource code development work than smaller players. However, even as a larger player, we are equally concerned about the constant change, increased complexity and fragmentation arising from code modifications. A solution that ensured decisions take account of the views of both small and large players would in our view provide for a more efficient and accessible process for all affected parties.

### **Critical analysis of modification proposals**

Ofgem raises in this section concerns and criticisms about the quality and depth of analysis provided in code modification reports and the extent to which argument are well-substantiated.

We are clearly in favour of clear, accurate and well-substantiated reports to support code modification proposals. We believe that, ultimately, the burden of proof for change should surely rest with the proposer who has to demonstrate the code objectives (typically competition and efficiency benefits) are better facilitated. It is not, nor should it be, a requirement of code modification processes to make a case for the status quo.

In some cases it may not be appropriate, or indeed possible, for the industry to carry out in depth qualitative and quantitative analysis of proposals. Whilst it is right that arguments for and against are explored and coherently expressed, some of the more controversial proposals may involve redistributional effects, substantial costs, or changes in relative competitiveness which parties may be unwilling to discuss in detail in an open forum, but are able to share with Ofgem. This can in itself limit the scope of assessment of proposals by working groups.

We agree that improvements could be made in articulating arguments better and in presenting reports more as stand-alone documents. However, in general, we do not consider that there is a "lack of effective and critical assessment of modification proposals" arising from the current code modification processes. We note, however, that Ofgem cites a number of examples<sup>4</sup> where it considers modification reports have been of poor quality and we think it would be useful for the review to study these in more detail.

The role of workgroups is to carefully consider arguments for and against a proposal, verify any evidence presented to them and suggest viable alternatives where appropriate. Where this has to be done under an expedited timetable, as is being considered in the case, for example, of the recent highly complex BSC cash-out proposal P217, this will almost inevitably have a deleterious effect on the quality of the final output.

### **The relevance of code objectives**

In principle we consider it would be appropriate to consider, where relevant, aligning each code's applicable objectives (or the equivalent) with the Authority's wider statutory duties. This makes sense in terms of the codes where a right of appeal to the Competition Commission may apply, as unnecessary appeals could arise simply from a Panel making a recommendation on a narrower basis. It would also seem sensible for the code objectives to reflect the hierarchy of Ofgem's

---

<sup>4</sup> UNC proposals 088 and 0149, and BSC proposals P212 and P213.

statutory duties.

In considering alignment of objectives it will nevertheless be important to consider how these fit with the statutory and licence objectives of network businesses.

### **Charging methodologies**

We are generally happy with the consultation processes managed by network operators. Our views are often taken into account and although, as a user, we are unable to propose changes, we have not found this to be an impediment to our having our concerns or ideas discussed. Indeed, at the various charging methodology fora, we are actively encouraged to present our views. At the current time we are not persuaded that allowing users to propose changes to the charging methodologies is necessary.

One of the positive aspects of the processes for considering changes to charging arrangements is that network operators are not obliged to pursue changes in the light of consultation responses. This is a principle that could well be adopted in for industry codes<sup>5</sup> with proposals that are not supported by the relevant Panel not going forward to Ofgem for consideration. This process also benefits from a fixed timetable for Ofgem deliberations on whether to veto a proposal. Adopting such a concept for code modification decisions would be helpful in removing the uncertainty inherent in an open ended decision making process.

We think the transparency of the consultation processes could be enhanced to some degree if the administration of the consultation process and the publication of charging consultations and associated methodologies were to be managed by the relevant independent code administrator where such a body exists.

### **Other issues**

We consider that all the issues described under this heading of the open letter are worthy of consideration. Our view is that there would be great benefit in focusing on self-determination and the structure of code Panels and, as stated earlier, we believe a meaningful review of industry code governance cannot be achieved without consideration of the balance of powers and functions between the industry and Ofgem in the process. The review should look at the respective roles of Ofgem, the industry and, for example, customer representatives, to ensure that there is a common understanding of what role each should play in the process, and the scope of that role.

*How* Ofgem engages in the process is very important – where Ofgem is to be involved, **active** involvement is in our view helpful. We want to see one holistic process, neither an industry modification process with Ofgem watching from the sidelines, nor a separate Ofgem process with the industry wondering what is going on at 9 Millbank.

We find it helpful for Ofgem staff to attend and participate in workgroups and believe that it should be possible for Ofgem personnel to do this on a “without prejudice” basis to inform the process. Indeed such groups can be more effective if they take account of Ofgem views but they

---

<sup>5</sup> Some codes such as the Uniform Network Code allow parties to withdraw a proposal that has little support thereby reducing the work burden of the relevant workgroups.

should not necessarily be bound by them. One important outcome that might come out of this review is around how we can best facilitate a constructive dialogue.

We also believe the Ofgem should consider making its code decision making processes more transparent, including indicating when key decisions are likely to be made, publication of relevant supporting Authority papers and the voting of Authority members on code modification decisions. Much uncertainty arises from not knowing when and on what basis decisions will be made and early guidance on this would be helpful.

In addition, to foster greater regulatory certainty and predictability, it would be helpful if Ofgem were, as part of its modification decisions, formally to review relevant precedents arising from past decisions. There are times where Ofgem's decisions appear to be at odds with past decisions and it would be helpful if a more detailed rationale as to why matters have changed<sup>6</sup>, distinguishing the present situation from the historic one, could be articulated in code modification decision letters, especially where this has been identified by the respondents through the code modification process. This is not going so far as having a system of binding precedent, but merely seeking to ensure that the industry has a better understanding of Ofgem's decisions and a greater ability to predict what its position is likely to be in a particular area.

We trust you will find these comments helpful and look forward to engaging further with you in this process.

Yours sincerely,

Peter Bolitho  
Trading Arrangements Manager

---

<sup>6</sup> For example the decision to reject CUSC amendment CAP146 seems to contradict Ofgem's long standing support for a "shallow connection policy"