

Modification proposal:	Uniform Network Code (UNC¹) 312: Introduction of Two-Thirds Majority Voting to the UNC Modification Panel (UNC 312)		
Decision:	The Authority ² has decided to reject this proposal		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	20 July 2011	Implementation Date:	N/A

Background to the modification proposal

The UNC Panel³ collectively provides a recommendation to the Authority on whether a modification to the UNC should be approved or not. Eleven Panel members⁴ may vote on a modification recommendation. The Panel's final recommendation to approve a modification requires a simple majority in favour of a proposal - one vote more in favour of a modification than against, excluding abstentions. Failure to achieve a simple majority leads to a Panel recommendation to reject.

Should the Authority's decision on a UNC modification differ from the Panel's majority recommendation, an aggrieved party who wishes to legally challenge that decision may seek to bring an Energy Code Modification Appeal to the Competition Commission (CC)⁵. The appeals process was introduced by the Energy Act 2004 and is underpinned by secondary legislation. The UNC is a designated code for the purposes of the CC appeals process. The circumstances in which an appeal may be brought are circumscribed - an appeal on a UNC modification is excluded where the Authority's decision accords with a majority recommendation made by the Panel⁶. In these circumstances, an aggrieved party who wishes to challenge an Authority decision that accords with the Panel's recommendation may only do so by way of judicial review.

As a result of Ofgem's Code Governance Review (CGR)⁷, the Significant Code Review (SCR) process was introduced to allow Ofgem to initiate a discussion on significant changes to industry codes and licences which may be needed to address a specific issue with cross-code and cross-code/licence impact identified by Ofgem as a result of, amongst other things, its wider statutory duties. On the conclusion of a SCR process, the Authority may direct the relevant licensee to raise changes to relevant codes and the licensee is obliged to do so. In the case of the UNC, the Gas Transporters would be

¹ The Gas Transporters are under an obligation through their Gas Transporter Licences to establish network codes which set out the contractual framework by which gas is to be transported across their pipeline system, and to establish and operate rules for modifying the network codes. The UNC was prepared by the Gas Transporters pursuant to Standard Special Condition A11 of their Transporter Licences:

<http://epr.ofgem.gov.uk/index.php?pk=folder590301>

² The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority (GEMA).

³ The UNC Panel is established and constituted from time to time pursuant to and in accordance with the UNC Modification Rules.

⁴ The Panel consists of 5 appointed representatives of gas transporters, 5 appointed representatives of gas shipper/supplier users and 1 representative appointed by the relevant consumer body (Consumer Focus). Panel members may represent those who have appointed them.

⁵ Details of the appeals process for energy code changes are set out on the Competition Commission website: <http://www.competition-commission.org.uk/appeals/energy/>

⁶ SI 2005/1646 article 10 (1).

⁷ The Code Governance Review final proposals are available here:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=297&refer=Licensing/IndCodes/CGR>

obliged, at the Authority's direction, to raise a UNC modification(s) as a result of a SCR⁸. Once raised, the modification follows the normal industry process culminating in a Final Modification Report (FMR) being referred to the Authority for decision.

The modification proposal

The proposer, E.ON UK, raised modification proposal UNC312 in October 2010. The proposal seeks to amend the UNC Modification Rules in the following way:

- when a Gas Transporter is directed through its licence to bring forward a modification, a Panel recommendation to approve the modification would require a two-thirds majority of Panel members who vote. In the case of the current Panel, at least 7 members (out of 11) would need to support approval of the modification if all Panel members voted;
- the requirement for a two-thirds majority would apply to modifications raised in response to a direction originating in a licence condition, for instance as the result of a SCR direction, or where a modification arises from an industry review process directed as the result of a licence condition. The legal text identifies SCR directed modifications as the only ones to which this definition currently applies;
- the proposer of the modification, a respondent to a consultation on the modification or a Panel member can trigger the requirement for a two-thirds majority vote. The UNC Panel would determine, by simple majority whether a simple majority vote or two-thirds majority vote is required for the Panel's recommendation. If the Panel cannot determine which voting threshold applies, the Panel's recommendation is provided by simple majority vote;
- the voting threshold to apply to each alternative to the original licence directed modification would be determined in its own right and there would be no automatic application of the same voting threshold to the original and any/all alternatives.

In the proposer's view, the accountability and transparency of the industry code modification process is enhanced by an effective modification appeals process but a licence directed modification proposal may be viewed as being controversial as it originates from the regulator and not a UNC signatory. As such, it is important that parties' rights to appeal are assured under the Energy Codes Modification Appeals process. The proposer referred to comments made by the CC in the UNC116 appeal and the perception of prejudgment in circumstances where the Authority is the promoter of a proposal. It is suggested that concerns on the scope for or potential accusations of prejudgment by the Authority would be met by the extra safeguard proposed by the modification. Reference is made to the risk that code parties may feel obliged to vote for a proposal originating from a condition of their licence, and it is this potential skewing of the Panel vote that this proposal also seeks to address.

In terms of the relevant objectives, the proposer considered that the modification would better facilitate effective competition – by reinforcing the concept of separation of powers and maintaining an effective appeals mechanism, the intended effect of the proposal is to protect the open and participatory regulatory decision making process. This may be expected to provide confidence in the regulatory system which may ultimately attract new entrants to the market or improve competition. The proposer also considered that

⁸ Standard Special Condition A11.10 (aa)

the modification would promote efficiency in the implementation and administration of the network codes by ensuring the need for greater consensus between the proposer, Ofgem and industry parties before a licence directed modification is raised. If a consensus did not arise, this would be reflected in a Panel recommendation to reject which, in the event that the Authority approved the modification, would keep open the right of a CC appeal.

UNC Panel recommendation

The UNC Modification Panel considered UNC312 on 16 June 2011 and of the eleven possible votes, five were cast in favour of implementing the modification. The Panel therefore did not approve implementation of UNC312.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the FMR dated 17 June 2011. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR⁹.

The Authority has concluded that implementation of the modification proposal will not better facilitate the achievement of the relevant objectives of the UNC¹⁰.

Reasons for the Authority's decision

We note that there were mixed views in support of and opposed to the proposal. The main arguments were provided against two of the UNC Relevant Objectives.

Standard Special Condition A11.1 (d): securing effective competition between shippers, suppliers, etc

We note the views of those supporting the proposal that accountability and 'checks and balances' are required in circumstances where the Authority is regarded as the originator of a code modification. Given these new powers, it is said that a slightly higher hurdle should be introduced to maintain an appropriate appeals mechanism to provide for scrutiny of contentious proposals. We also note the concerns of those respondents that the Authority could, for licence directed modifications, be seen as 'judge, jury and executioner' which may result in an insufficient separation of powers. By maintaining an effective appeals mechanism, the intended effect of the proposal is to protect the open and participatory regulatory decision making process. This may be expected to provide confidence in the regulatory system from justice being seen to be done which may ultimately attract new entrants to the market or improve competition between existing shippers.

We do not agree that the proposal would better facilitate this objective. The SCR process is intended to be open, transparent and accessible to all parties. One of our concerns when initiating the Code Governance Review was that it was the lack of transparency and inclusivity of code change processes that may deter new entrants and small participants from involvement in energy markets. While the Authority leads the SCR process, we are

⁹ UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at <http://www.gasgovernance.co.uk/>. The Joint Office is the code administrator for the UNC.

¹⁰ As set out in Standard Special Condition A11(1) of the Gas Transporters Licence, see link at footnote 1.

committed to ensuring that each SCR is carried out in an open and inclusive manner and that all interested parties can engage with the process to address the issues highlighted by the Authority.

Similarly, at the conclusion of a SCR process, the Authority would, based on the evidence gathered during the process, determine whether any SCR directed modification(s) is needed. There is no requirement on the Authority to direct a licensee to raise code changes and those changes which are directed may allow the relevant licensee some flexibility within the scope and intent of the direction, allowing for further development of proposals through the code governance processes. Ofgem would keep an open mind on the development of any SCR directed modifications prior to the delivery of the FMR.

Ofgem has recently launched two SCRs¹¹. As neither has concluded, it is too early to say whether our and parties' expectations of the SCR process have been borne out. We will keep the present arrangements under review and have indicated that external factors may affect the future development of the code governance processes¹². We consider that the arguments in favour of the proposal give rise to benefits that appear at best to be tenuous when compared against the relevant objectives and do not consider that the proposal addresses a genuine issue at this time. However, should we consider it appropriate to refine the SCR process further in light of experience, we would be willing to undertake a review with industry at the relevant time.

We do not agree that the relevant licensee which raises a SCR directed modification would be expected to vote in favour of it at the Panel vote. The CGR licence changes make it clear that any Authority direction(s) to a Gas Transporter licensee to raise a SCR directed modification do not fetter the voting rights of the UNC Panel members¹³ - the licence explicitly preserves the status quo in this respect. We therefore do not agree that there would be a presumption that the relevant Panel members would always vote in favour of a SCR directed modification raised by their company. In our view, no strong case has been presented that there is an obvious defect in the current governance arrangements and we can see no justification at this time to consider making it more difficult for the Panel to achieve a majority recommendation for licence directed modification proposals and for treating such proposals differently to other modification proposals with regard to voting thresholds.

Standard Special Condition A11.1 (f): promoting efficiency in the implementation and administration of the network code

We note the arguments made in support of the proposal against this objective that a desire for consensus may allow the development of SCR directed proposals that have broad support from industry and the regulator, in the absence of which a higher voting threshold would preserve the appeal rights of parties. We also note the counter-arguments that significant code changes involve 'winners' and 'losers' and therefore it is unlikely that consensus will be achieved.

We do not consider that the proposal better facilitates this objective. The proposal would if implemented establish a number of additional voting processes that would need to be undertaken to determine whether a SCR directed modification(s) and any alternatives would require a Panel recommendation based on 'simple' majority or 'two thirds' majority

¹¹ A gas Security of Supply SCR was launched in January 2011 and Project TransmiT was launched as a SCR in July 2011. Details of both are available on the Ofgem website: <http://www.ofgem.gov.uk/>

¹² E.g. We referred to the implementation of the Third Package in CGR final proposals.

¹³ Standard Special Condition A11.15C.

prior to any vote on the modification(s) itself. It is possible that the directed mod would require two thirds majority recommendation but that an alternative could be considered on the basis of simple majority. In our view, this would introduce additional complexity into the governance process that would not better promote efficiency of the UNC modification arrangements.

Other issues arising from modification UNC312

More broadly, we have noted the views of Consumer Focus that the approval of this modification would set a precedent to unwind or materially alter the application of a statutory appeals process that has been subject to Parliamentary scrutiny through the industry codes modification process. In rejecting the proposal on its merits, whilst it would have been helpful for this issue to have been squarely addressed in the FMR, we have not needed to reach a final view on this aspect of the proposal for the purposes of our decision.

We also note the wider comments of the CC in the UNC116 appeal and the risks of considering selected extracts of the CC's decision in isolation - the issue of prejudgement was not upheld in that case notwithstanding strongly held GEMA views which it maintained having listened to contrary industry opinion. The CC accepted GEMA's submission that it has an agenda based on its statutory obligations, and that it will necessarily carry that agenda, and certain long-held opinions into the process of deciding upon code modifications.

Decision notice

In accordance with Standard Special Condition A11 of the Gas Transporters Licence, the Authority hereby directs that modification proposal UNC312: *'Introduction of Two-Thirds Majority Voting to the UNC Modification Panel'* be rejected.

Declan Tomany

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Signed on behalf of the Authority and authorised for that purpose