

Workstream Report
Introduction of Two-Thirds Majority Voting to the UNC Modification Panel
Modification Reference Number 0312
Version 0.4

This Workstream Report is presented for the UNC Modification Panel's consideration. The Governance Workstream considers that the Proposal is sufficiently developed and should now proceed to the Consultation Phase. The Workstream also recommends that the Panel requests the preparation of legal text for this Modification Proposal.

1 The Modification Proposal

Nature:

It is proposed that where a direction is made as a result of an obligation or condition in a Gas Transporter Licence which requires that the Transporter bring forward a UNC Modification Proposal, a recommendation to implement that Proposal by the UNC Modification Panel must be based on gaining at least two-thirds of votes in favour of implementation cast by those Panel members present.

To illustrate this proposal using the current UNC Modification Panel arrangements; assuming a Panel comprised of 5 Transporter representatives, 5 Shipper representatives and 1 consumer representative and that all votes are cast, it would take at least 7 votes in favour for the Modification Panel to recommend implementation of a UNC Modification Proposal originating from a licence condition. If this proposal is not implemented, it would continue to take 6 votes in favour to achieve a majority recommendation to implement for such Modification Proposals.

For clarity, it is intended that two-thirds majority voting should only apply to Modification Proposals arising either directly from an obligation or condition to bring forward a proposal¹ (i.e. a Modification Proposal raised in response to a direction originating from a licence condition) or indirectly (i.e. a Modification Proposal arising from an industry review process which was initiated to meet a direction originating from a licence condition) from a Transporter's licence condition.

It is proposed that the current simple majority vote shall continue to apply for the purposes of the Panel determination as to whether to recommend implementation, except where the proposer, a respondent or a UNC Panel Member represents that a UNC Modification Proposal addresses the requirements (in full or in part) of a

¹ This would also include proposals arising from a "Significant Code Review" (SCR) should such a concept be adopted under the UNC in future.

licence direction. In this instance, the Modification Panel shall be required to take a simple majority vote to decide whether simple majority or two-thirds majority voting shall apply for the purposes of the Panel determination as to whether to recommend implementation.

Each vote shall be an affirmative vote that in the view of the Modification Panel member, implementation of the Proposal would address the requirements of a licence direction in full or in part. Where a simple majority (of the votes cast) is achieved at this stage, the Modification Proposal shall then be subject to two-thirds majority voting for the purposes of the Modification Panel then making a determination as to whether to recommend implementation. Where the Panel is unable to achieve a simple majority (of the votes cast) at this stage, the Modification Proposal shall remain subject to simple majority voting for the purposes of the Modification Panel making a determination as to whether to recommend implementation.

For clarity, it is intended that each Modification Proposal and each alternative Modification Proposal shall be treated individually and on its own merits. Therefore, it would not automatically follow that if an original Modification Proposal had been determined by the Modification Panel to be subject to two-thirds majority voting that the alternative Modification Proposal shall be also.

Purpose:

The changes proposed here would replace the current arrangements, where a simple majority (i.e. over 50% of the votes cast) is required to recommend implementation of any UNC Modification Proposal. In practice, this means that a Modification Proposal can currently be recommended for implementation provided all Transporter representatives recommend implementation, plus just one Shipper or consumer representative (or all Shipper representatives plus one Transporter or consumer representative), despite the fact that the proposal may be a fundamental change to the terms of their contract under the UNC.

Furthermore, Modification Proposals originating from a licence condition tend by definition to be controversial, since they originate not from a signatory to the UNC, but from the Regulator. In many cases, such as “Exit Reform”, these proposals represent a fundamental change to the terms of the UNC. It is all the more important then, that materially affected parties have their views seen to be taken into account in the decision making process, but without creating an unreasonably high hurdle that might lead to filibustering by parties opposed to a change.

The accountability and transparency of the industry code modification process is

² Para 6.192, ‘Decision and Order of the Competition Commission’, 10 July 2007.

³ It could be argued that it is difficult for a monopoly network business to genuinely express their views on such Modification Proposals, as to do so may potentially undermine their ongoing regulatory relationship with Ofgem.

enhanced by an effective modification appeals process. Therefore, it is particularly important that affected parties' rights to appeal (including the rights of consumers) are assured under the statutory Energy Codes Modification Appeals process. In the UNC116 appeal process the Competition Commission expressed concerns where Ofgem is closely involved in the origination of Code Modification Proposals:

“[I]t is less clear that the system of checks and balances established in the code modification procedures works if GEMA is, to use GEMA’s words, the ‘effective progenitor’ of a proposal (or at least if it is perceived as such). The existing system envisages that GEMA will express a firm view as to what (if any) reform ought to take place at the conclusion of the process, rather than at the start of the process. If GEMA is the effective progenitor of a proposal, there may be a perception that it cannot fulfil its intended role under the UNC modification procedures without having prejudged, or at least appeared to prejudge, the matter.”²

Some Code parties may feel obliged to vote for a proposal originating from a condition of their licence³, and it is this potential skewing of the Panel vote that this proposal seeks to address. As a result, the proposer considers that the opportunity to appeal would be better safeguarded if this Modification Proposal were to be implemented.

In addition, there may be concerns about the scope for prejudgment and Ofgem acting as “judge, jury and executioner” should the SCR process outlined in Ofgem’s recent industry code governance review proposals be implemented. The extra safeguard proposed here, of commanding a two-thirds majority, should also help protect Ofgem from potential accusations of pre-judgement.

2 User Pays

a) **Classification of the Proposal as User Pays or not and justification for classification**

No UK Link impact has been identified by the Proposer and therefore this proposal is not classified as “User Pays”.

b) **Identification of Users, proposed split of the recovery between Gas Transporters and Users for User Pays costs and justification**

No User Pays charges applicable.

c) **Proposed charge(s) for application of Users Pays charges to Shippers**

No User Pays charges applicable to Shippers.

d) **Proposed charge for inclusion in ACS – to be completed upon receipt of cost**

estimate from xoserve

No charges applicable for inclusion in ACS.

3 Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Standard Special Condition A11.1 (a): *the coordinated, efficient and economic operation of the pipe-line system to which this licence relates;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (b): *so far as is consistent with sub-paragraph (a), the (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (c): *so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (d): *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition: (i) between relevant shippers; (ii) between relevant suppliers; and/or (iii) between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;*

As an independent regulator, Ofgem is still an administrative body of government and independence does not mean that the regulator should function in a vacuum. Accordingly, its actions should be monitored so that it is fully accountable for those actions. To help facilitate accountability, a system of 'checks and balances' is required. The main check currently on substantive decisions by Ofgem comes from the ability of companies to appeal to the Competition Commission. This process allows Code Modification decisions to be independently reviewed, thereby preventing the concentration of powers in a single body (Ofgem). Some Code parties have raised concerns that the proposed SCR process may result in insufficient separation of powers (i.e. Ofgem effectively acting as "judge, jury and executioner") for the purposes of industry Code governance. Therefore, to maintain balance and to ensure effective separation of powers, the new powers for Ofgem to effectively originate Modification Proposals under SCRs means that the process for arriving at a Panel recommendation must change in response, by introducing a slightly higher hurdle in order to maintain the efficacy of the statutory Energy Code Modification appeals process as envisaged by Parliament.

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, where industry participants believe that regulatory decisions take their interests into account. This, in turn, 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 (SSC A11.1 (d)).

Standard Special Condition A11.1 (e): *so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A (Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers’ licences) are satisfied as respects the availability of gas to their domestic customers;*

Implementation would not be expected to better facilitate this relevant objective.

Standard Special Condition A11.1 (f): *so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.*

Requiring a higher (two-thirds) threshold of support to achieve a Panel recommendation should itself act as an inducement between proposer, Regulator and wider industry to co-operate on SCR-originated proposals, ensuring as far as possible that a proposal has a broad level of industry support. Failure to achieve a broad level of industry support will almost certainly result in a failure to achieve a recommendation to implement by the Panel (which acts as a filter for appeals broadly based around industry consensus). This in turn opens up the potential for affected parties to access the Competition Commission appeal mechanism if Ofgem were to subsequently disagree with the Panel’s majority view. Ensuring that SCR proposals reflect broad industry consensus should result in fewer subsequent regulatory interventions or issues being re-visited, which may be considered to better facilitate the relevant objectives in terms of promoting efficient administration of the UNC (SSC A11.1 (f)).

4 The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

No implications on security of supply, operation of the Total System or industry fragmentation have been identified.

5 The implications for Transporters and each Transporter of implementing the Modification Proposal, including:

a) implications for operation of the System:

No implications for operation of the system have been identified.

b) development and capital cost and operating cost implications:

No development or capital costs would be incurred.

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

No additional cost recovery is proposed.

d) Analysis of the consequences (if any) this proposal would have on price regulation:

May reduce the contractual risks arising from controversial Modification Proposals being implemented without the possibility of a Competition Commission Appeal.

6 The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

No such consequence is anticipated.

7 The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

No changes to systems would be required as a result of implementation of this Proposal.

8 The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

Administrative and operational implications (including impact upon manual processes and procedures)

No such implications have been identified.

Development and capital cost and operating cost implications

No such costs have been identified.

Consequence for the level of contractual risk of Users

May reduce the contractual risks arising from controversial Modification Proposals being implemented without the possibility of a Competition Commission Appeal.

9 The implications of implementing the Modification Proposal for Terminal

Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

The effect of the proposal is to protect the open and participatory regulatory decision-making process, where industry participants believe that regulatory decisions take their interests into account. The proposer believes that this is likely to maintain or improve confidence in the Code governance process and effectiveness of the overall regulatory regime. This may serve to enhance confidence in the market for any industry participant or affected party.

10 Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

A recommendation to implement by Panel may be considered to carry more weight, therefore giving a greater degree of legitimacy to proposed Code changes originating from a licence condition.

11 Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages

- The key advantages of implementation are set out in detail at Section 3, above.

Disadvantages

- By introducing new rules, the proposal may be considered to add some additional complexity to the existing governance process.

12 Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Workstream Report)

Two-thirds majority voting as a concept has been discussed and debated in recent Governance Workstreams and support for the idea has been expressed by some Code parties.

13 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

An earlier version of this proposal has been discussed at several Governance Workstreams and comments received have been considered by the Proposer and included, where appropriate.

14 The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of

Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

No such requirement has been identified.

15 Programme for works required as a consequence of implementing the Modification Proposal

No programme for works has been identified.

16 Proposed implementation timetable (including timetable for any necessary information systems changes)

The proposer suggests a 31 December 2010 implementation date to align with the proposed implementation dates for UNC Mods 0318 - 0325 'Suite of Proposals raised to implement the Industry Codes Governance Review'

17 Implications of implementing this Modification Proposal upon existing Code Standards of Service

No implications of implementing this Modification Proposal upon existing Code Standards of Service have been identified.

18 Workstream recommendation regarding implementation of this Modification Proposal

The Governance Workstream considers that the Proposal is sufficiently developed and should now proceed to the Consultation Phase. The Workstream also recommends that the Panel requests the preparation of legal text for this Modification Proposal.