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interested parties

Your Ref:  
Our Ref: Net/Cod/Mod/048  
Direct Dial: 020 7901 7355  
Email: [industrycodes@ofgem.gov.uk](mailto:industrycodes@ofgem.gov.uk)

16 December 2005

Dear Colleague,

**Uniform Network Code modification proposal 048: 'Preparation of legal text for Users modification proposals'.**

Having considered the issues arising from this proposal and having regard to its statutory duties<sup>1</sup> Ofgem<sup>2</sup> has decided to direct the implementation of the modification, as it believes that it will better facilitate the achievement of the relevant objectives of the Uniform Network Code (UNC), as set out in standard special condition A11<sup>3</sup> of relevant Gas Transporters licences. In this letter we explain the background to the modification proposal and outline the reasons for making our decision.

**Background**

Currently, the UNC modification rules provide that legal text will be prepared for any modification proposed by a Gas Transporter (GT), whereas in the case of a User proposal the provision of legal text will be subject to that proposal being recommended by the modification panel, or a request from Ofgem for the GTs to produce such text.

In practice this means that legal text for GT proposals is provided with the Draft Modification Report (DMR) and therefore itself subject to comment as part of the consultation process. In contrast, User proposals often do not have legal text attached and the first opportunity Users get to see it is as part of the Final Modification Report (FMR) submitted to the modification panel. At this stage the panel is limited to commenting on whether the FMR is in the correct form and determining whether or not to recommend the implementation of the modification proposal as drafted, rather than further developing the associated legal text.

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<sup>1</sup> Set out in Section 4AA of the Gas Act 1986, as amended.

<sup>2</sup> Ofgem is the Office of the Gas and Electricity Markets Authority. The terms 'Ofgem' and 'the Authority' may be used interchangeably in this letter.

<sup>3</sup> This Licence Condition can be viewed at: [http://62.173.69.60/document\\_fetch.php?documentid=6547](http://62.173.69.60/document_fetch.php?documentid=6547)

## **The Modification Proposal**

This modification proposal seeks to introduce a requirement for the GTs to arrange for the provision of legal text to accompany the Draft, rather than Final, Modification Report. However, this will still be subject to the discretion of the modification panel, insofar as it may determine that legal text would not be required in certain circumstances.

### **Respondents' views<sup>4</sup>**

There were eleven representations received in response to the consultation on this proposal, eight of which were in support of its implementation, with three opposed. The majority of respondents agreed with the proposer that the early provision of legal text would enhance the consultation process, particularly by providing greater clarity and aiding understanding of the proposal. Some agreed with the proposer that it is the legal text that represents the actual amendment of the common contract, the UNC, and that it is important for each party to have opportunity to view and comment upon it, particularly for complex proposals. One respondent added that they had experienced occasions where there had been inconsistency between what has been put forward in a modification proposal compared with the legal text that had subsequently been provided with the FMR.

The three respondents opposed to implementation, all of whom are GTs with collective responsibility for the provision of legal text, considered that this proposal would be less efficient than the current arrangements and increase costs. One respondent raised concerns at the production of legal text being at the panel's discretion and the potential nature of voting, suggesting there would be little incentive for shippers to vote for the GTs to be relieved of their obligation to provide legal text. They also suggested that resources should be targeted on proposals most likely to be implemented. Another respondent considered that under this proposal, if the modification panel vote on whether to produce legal text is split, the default would be for the legal text to be produced. They went on to suggest that this would be inconsistent with other panel voting arrangements, where a majority is required to approve an action, rather than forego one.

Five of the respondents in favour of implementation provided specific comments on the costs of producing legal text more often and at the panel's behest, including one of the GTs with shared responsibility for the provision of such text. They did not consider that the additional costs would be significant and would be outweighed by the benefits to the consultation on, or subsequent implementation of, each modification proposal. One suggested that it should be possible for the panel to be provided with an indication of the likely costs of producing legal text, which may assist them in determining whether it would be efficient and economic to provide at that stage.

Some respondents raised concerns that by the panel determining whether or not legal text should be produced as part of the DMR, it would reveal the voting preferences of panel members at an early stage. Other respondents commenting on this same point did not consider this to be a problem, particularly as the decision that the panel is being asked to make is

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<sup>4</sup> This section is intended to summarise the principal themes of the respondents' views and is not intended to provide a comprehensive overview of the responses received. These can be found on the Gas Transporters Information Service <https://gtis.gasgovernance.com>.

different. It was noted that determining that a proposal is sufficiently clear to proceed to consultation should not itself be construed as the panel's support for a proposal and should not fetter its discretion over the subsequent recommendation.

Some respondents, both for and against the proposal, commented that under this proposal the legal text will ordinarily need to be prepared within the fifteen working days allowed for production of the DMR, which may prove to be insufficient if the transporter's legal resource has not been properly briefed. However, one respondent noted that the panel could determine a longer period for the preparation of a DMR and associated legal text. There was also concern that complex or poorly defined modification proposals may require significant discussion between the drafting lawyer and the proposer in order to provide appropriate legal text, which could cause delays to the consultation timetable.

There were some concerns that the lawyer responsible for drafting the legal text, likely to be an employee of a GT, may be placed in a conflict of interest where the GTs do not support the proposal themselves. As a potential remedy, some respondents suggested that it may be appropriate for the proposer themselves to commission legal drafting in the first instance. Several other respondents variously commented that the ability for shippers to provide legal text already exists and/or should be encouraged; is beneficial to the understanding of the proposal, or; would in no way be precluded by the implementation of this proposal.

Another suggested remedy to the conflict of interest was for legal text to be produced at the request of Ofgem. Other respondents suggested this as an efficient means of ensuring that legal text is only produced for those proposals which are likely to be approved. However, some respondent also commented that irrespective of legal text, Ofgem should have enough information to make a judgement on the merits of the proposal against the relevant objectives. They also pointed out that legal drafting should not be a replacement for quality drafting of the proposal itself.

### **Panel recommendation**

At the Modification Panel meeting held on 1 December 2005, of the 9 Voting Members present, capable of casting 10 votes, 7 votes were cast in favour of implementing modification proposal. Therefore, the Panel recommended the implementation of this modification proposal<sup>5</sup>.

### **Ofgem's view**

Having considered the views of respondents and the Modification Panel, Ofgem considers that modification proposal 048 would better facilitate achievement of the relevant code objectives compared to the existing provisions of the UNC. Although it is primarily the principles of the proposal as contained within the modification report which forms the basis for the consultation and subsequently, Ofgem's decision, the legal text is, as several respondents pointed out, the actual modification and crucial to the effective implementation of proposals. Although, Ofgem can and does make decisions in the absence of legal text, this can only be in instances of rejection where it is evident from the nature of the proposal alone that it does not further

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<sup>5</sup> A Panel recommendation requires a majority vote from voting members at a quorate meeting of the Modification Panel.

facilitate the relevant objectives. However, where Ofgem is minded to accept a proposal it must additionally be satisfied that the provided legal text satisfies the stated intent of the proposal.

Ofgem notes that several respondents felt that this proposal would impede the efficiency of the existing modification process, either through the premature and potentially unnecessary production of legal text or delays that may be introduced as a result of this additional requirement. However, Ofgem considers that the early production of legal text will actually improve the efficiency of the modification process. Ofgem agrees with those respondents who stated that the availability of legal text would improve respondents understanding of the proposal and therefore the consultation process. This should also obviate the need for subsequent clarification notes. Moreover, the implementation of this proposal, together with increased emphasis on early discussion of the legal text and development of the proposal more generally, may provide greater opportunity to address any perceived defect in the code first time, rather than requiring iterative incremental improvements to the same area. Ofgem therefore considers that this proposal, whilst perhaps requiring more resource for the production of each DMR, may in the long run reduce the number of modification proposals that are considered necessary and therefore improve the efficiency of the modification process as a whole.

With regard to the suggestion that indicative costs could be provided to the panel, Ofgem considers that there may be value in providing greater transparency of the costs of providing legal text for modification proposals, in order to determine whether the prevailing arrangements are effective and efficient. However, Ofgem does not at this time consider that it would be practicable or appropriate to provide this information on a case by case basis, as this could itself introduce delays into the process and may unduly influence the panel's decision. The decision on whether or not to produce legal text as part of the DMR should appropriately be based upon whether it would add value to the consultation process, given the relative clarity of the modification proposal, regardless of the nature of the proposal. As highlighted by some respondents, it is the more complex proposals that would benefit most from the additional clarity provided by legal text, yet it is these same proposals that would ordinarily be expected to have the highest associated legal drafting costs. Ofgem considers that to forego legal text on the most complex of proposals would be, at best, a false economy.

Ofgem has noted, and to an extent shares, concerns that the reasons for legal text not being produced as part of the DMR may be perceived as reflective of the merits of the proposal, as this could prejudice the outcome of the consultation. However, Ofgem also considers that such decisions will be in keeping with existing panel discretion over whether a proposal is sufficiently clear to proceed to consultation. It follows that if the proposal is not sufficiently clear to proceed to consultation and be adequately understood by respondents, nor will it be sufficiently clear to a lawyer being asked to draft legal text in facilitation of that proposal. It may be appropriate for the panel's reasons for not requiring legal text to be noted, with confirmation that they are not indicative of the panel's views of the merits of the proposal and will not fetter its subsequent decision on whether or not to recommend its implementation.

Ofgem has noted the concerns that the fifteen day period ordinarily allowed for the production of a DMR will not always be sufficient time for the drafting of associated legal text. However, Ofgem would anticipate that legal text will generally be requested for those proposals which are not yet sufficiently clear to proceed to consultation as drafted, and will instead be sent for further development. It is also anticipated that GT representatives in particular will feed into this development any issues which need addressing in order to produce appropriate and robust legal

text. Ofgem therefore considers that the timetable will ordinarily allow at least one month of development, then the subsequent fifteen days for the production of the DMR for the responsible lawyer(s) to first familiarise themselves with the proposal then produce the required text.

In instances where the modification panel consider the proposal is sufficiently clear to proceed to consultation but also requires legal text, it has, as noted by one respondent, discretion to determine a longer period for the production of a DMR, where appropriate.

Ofgem notes the suggestion that as a potential remedy to the conflict of interests, it could itself prompt the production of legal text. Whilst Ofgem can currently request legal text where none has previously been produced, Ofgem does not consider that this would be appropriate as part of the normal arrangements. As the decision making body Ofgem must remain appropriately distanced from the process leading up to the FMR being submitted to it for a decision. Therefore, Ofgem may not be in a position to appropriately request legal text until it has made at least an initial assessment of the proposal, which may negate the benefits to the consultation process that this proposal seeks to deliver. Nor does Ofgem consider that requesting legal text itself would address the real conflict of interest, insofar as one exists, of a GT appointed lawyer drafting text for a proposal that the GT itself may oppose.

Ofgem also notes the suggestion that Users could provide indicative legal text along with their proposals in the first instance. Whilst Ofgem does not consider that this would wholly address concerns about conflict of interest, given that the final text must still be produced by one of the GTs, there would be benefit insofar as the suggested text would increase understanding of the proposal and the quality of subsequent discussion and/or consultation. However, Ofgem would be keen to avoid further development of the proposal becoming focused on the particulars of the legal text rather than the issues it seeks to address or for the provision of legal text to become a pre-requisite of a modification proposal.

More generally, Ofgem does not consider that the situation with respect to conflicts of interest will be worse under this proposal than currently. As mentioned above, final legal text is currently provided by GT legal resource, regardless of the prevailing GT view. Moreover, the production of legal text is itself a GT obligation under the UNC modification rules and the lawyer concerned can appropriately be considered to be serving the GTs interests by discharging that obligation.

Ofgem considers that the implementation of this proposal would give the UNC modification panel an appropriate degree of discretion over the production or non-production of legal text which is in keeping with its established role in overseeing procedural aspects of the modification proposal. Ofgem also notes that this panel function would be similar to that provided by the Balancing and Settlement Code (BSC) panel in relation to the BSC, whereby modification groups shall seek the views of the BSC panel prior to taking any steps which may incur significant costs, including the commissioning of legal text<sup>6</sup>.

As the modification procedures are a requirement of Standard Special Condition A11 of the GT licence Ofgem considers that improvements to those procedures can be considered to further facilitate relevant objective c) *the efficient discharge of the licensees obligation under [that] licence*. Ofgem also considers that, to the extent that improved consultation can result in more

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<sup>6</sup> [Balancing and Settlement Code, Section F 2.6.8](#)

effective modifications, and in the long run perhaps fewer of them, the implementation of this proposal will further facilitate relevant objective f) *the promotion of efficiency in the implementation of the UNC*.

### **Ofgem's decision**

For the reasons set out above, Ofgem has decided to direct the relevant Gas Transporters to implement this modification to the UNC. If you have any comments or queries in relation to this letter, please email us at: [industrycodes@ofgem.gov.uk](mailto:industrycodes@ofgem.gov.uk)

Yours sincerely,

**Nick Simpson**  
**Director, Modifications**