ofgem

Bringing choice and value to customers

Our Ref: Net/Cod/Mod/0679
Direct Dial: 020 7901 7355
Email: nick.simpson@ofgem.gov.uk

7 June 2004

NGT, Shippers and other parties.

Dear Colleague,

Modification Proposal 679: 'Formally include Network Code Modification Rules within the Network Code'.

Ofgem has carefully considered the issues raised by modification proposal 679; 'Formally include the Network Code Modification Rules within the Network Code'. As a result, Ofgem has decided to direct Transco to implement the modification as we believe that it will better facilitate the fulfilment of the relevant objectives of Transco's Network Code.

Background to the proposal

The GT licence requires Transco to establish transportation arrangements consistent with its duties under section 9 of the Act and to facilitate the achievement of the relevant objectives. These arrangements are to be in a document referred to as the Network Code. The licensee is similarly required to prepare a document setting out the modification procedures for the Network Code. Currently, the Transco modification rules form a separate document to the Network Code itself. This has implications insofar as the modifications rules are not subject to the governance that they themselves provide.

Although changes to the Network Code modification rules are subject to the consent of Ofgem (following consultation) in the same way as changes to the Network Code itself, at present only Transco can formally raise them. Whilst other parties may suggest such changes, they are reliant upon Transco to progress them through the auspices of the Prioritisation sub-group of the Network Code Committee. In contrast, for example, the electricity Balancing and Settlement Code modification rules are part of the Code itself, with all parties being assigned the same rights to propose change.

The Modification Proposal

This modification proposal seeks to include the Network Code modification rules formally into the Network Code itself. In effect this would mean that the modification rules would constitute part of the Network Code and therefore be subject to the same change control procedures, allowing parties to the Network Code to propose changes to the rules.

Respondent's views

A total of twelve representations were received for this modification proposal, ten from Users and two from non-Network Code parties. All expressed broad support for the implementation of the proposal. Respondents concentrated on three main issues in their representations.

Licence changes

Eight of the respondents considered that there were no valid reasons to change Transco's Licence conditions in order to facilitate the implementation of this modification proposal. However, one respondent did express the view that a general review of the Network Code relevant objectives as defined in Standard Condition 9 of Transco's Licence may be necessary to establish whether they can be appropriately applied to potential proposals to amend the Network Code modification rules. Furthermore, it was suggested that the relevant objectives could be tailored specifically towards proposals to modify the modifications rules, similar to those currently used by the Balancing and Settlement Code and defined in Condition C3 (3) (d) of the Electricity Transmission Licence. (see appendix).

Consistency of governance

Three of the twelve respondents expressed the view that a consistent approach to governance across the gas and electricity regimes would be beneficial. However, both the proposer and one other respondent stated that creating commonality in governance was neither the intention of the proposal nor necessarily desirable.

Legal review

Views were expressed on whether the modification Rules, as currently drafted, are legally suitable for incorporation into the Network Code.

Two respondents believe that, as drafted, the modification rules are suitable for immediate inclusion into the Network Code. One respondent expressed the view that any re-drafting that does occur should only be for minor changes. Finally, one other respondent suggested that the Modification Rules would need a complete legal review prior to them being incorporated into the Network Code.

Transco's View

Transco's Final Modification Report states that while they support introducing a mechanism to allow Users to propose changes to the Network Code modification rules, they do not believe

that the current drafting of the Modification Rules or the existing Network Code relevant objectives provide an appropriate vehicle for it on this occasion. They also recommend that the issues detailed below should be considered as part of any future attempt to incorporate the modification rules into the Network Code.

Licence changes

Transco believes that consideration needs to be given to ensuring that the Transco GT licence is consistent with inclusion of the modification rules within the Network Code, particularly as the two documents are subject to separate provisions within Standard Condition 9.

Consistency of governance

Transco make no comments regarding the consistency of governance regimes across the gas and electricity markets

Legal review

Transco expressed concerns that the modification rules would not, as drafted, operate effectively as part of the Network Code. No further details were provided on this point. Also, Transco noted that there are currently no guidelines by which to judge the merit of proposed changes to the modification rules.

Ofgem's View

Ofgem welcomes the principle of more open access to the governance of gas and electricity industry codes by contractual parties and by appropriate consumer representatives. Open and transparent processes underpin effective and efficient consultation and consideration of Modification Proposals.

Licence changes

Condition 9 (6) of Transco's Licence states that the Licensee shall "prepare a document ("the code modification rules") setting out the procedures established in pursuance of paragraph 4, and shall furnish the Authority with a copy thereof;".

While the Network Code and Network Code modification rules are mentioned separately within the Licence, this does not preclude them from being part of the same document. Indeed, the Network Code of at least one of the independent GTs already incorporates its modification rules.

Ofgem notes that the Balancing & Settlement Code refers specifically to promoting efficiency in the implementation and administration of the balancing and settlement arrangements. However, in judging whether a change to the modification rules themselves would or would not be worthwhile it does not seem that an objective of this type adds any particular clarity. Ofgem holds the view that the current objectives as defined in Standard Condition 9 of the Gas Transporters Licence , in particular objective b), are adequate for judging the benefits of a modification proposal on rule changes, though Ofgem will continue to monitor the situation and

give further consideration to the possibility of reviewing the Network Code objectives at a future date, if appropriate

Consistency of governance

Three respondents advocated a consistent approach to governance across the gas and electricity markets. However, it is acknowledged that this was not the intention of the modification proposal. While harmonisation can be beneficial, it is important that each proposal is considered on its own merits, as something that works in one regime may not automatically work in another. Furthermore, the harmonisation of systems and procedures is not in itself a relevant objective and as such has not been relevant to our decision on whether to accept or reject this particular modification proposal.

Legal review

Transco's Final Modification Report contained a paragraph that was not relevant. Clause 11.6.1 states that "these Rules do not constitute part of the Network Code" so Ofgem requested that the legal text was re-submitted. As this change was of a minor nature and did not involve any material change it was not felt necessary to re-consult. Furthermore, the Modification Panel were made aware of this and endorsed the view that the proposal did not need to go through the consultation process for a second time.

Ofgem notes Transco's opinion that the rules are not appropriately drafted but would say that thus far, they seem to have operated in a satisfactory manner. It will be of course open to any party, including Transco, to raise a proposal to amend the rules. As Ofgem believes that good governance can lead to a more efficient pipe-line system and support the development of competition, any improvements to the governance of the Network Code should be welcomed. Ofgem has previously set out[1] what it considers to be, in this context, the principles of good governance that should be adhered to by any governing body, code or agreement, namely:

- Effectiveness;
- Efficiency;
- Transparency;
- Participation;
- Accountability; and,
- Consistency.

It would therefore be helpful if any party proposing a change to the rules could give consideration to these principles, in addition to the relevant objectives themselves.

Ofgem's decision

Having considered the issues raised by this modification proposal Ofgem has decided to direct Transco to implement modification proposal 679, as it will contribute to the efficient and economic operation of the pipe-line system by improving the existing governance procedures

[1] Gas Retail Governance – Further Consultation, June 2003

and contribute to the fulfilment of the relevant code objectives, particularly Standard Condition 9.1 (c).

If you have any further queries regarding this decision letter please feel free to contact Samantha McEwen on 020 7901 7032.

Yours sincerely,

Nick Simpson,
Director, Modifications

Appendix

Network Code Relevant Objectives:

a) the efficient and economic operation by the licensee of its pipe-line system;

b) so far as is consistent with sub-paragraph (a), the efficient discharge of its obligations under this licence;

c) so far as is consistent with sub-paragraphs (a) and (b), the securing of effective competition between relevant shippers and between relevant suppliers; and

d) so far as is so consistent, 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 Supplier's licences) are satisfied as respects the availability of gas to their domestic customers.

Balancing and Settlement Code Applicable Objectives:

a) the efficient discharge by the licensee of the obligations imposed upon it by its licence;

b) the efficient, economic and co-ordinated operation by the licensee of the licensee's transmission system;

c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity;

d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements;

e) the undertaking of work by BSCCo (as defined in the BSC) which is:

   (i) necessary for the timely and effective implementation of the proposed British Electricity Trading and Transmission Arrangements (BETTA); and

   (ii) relevant to the proposed GB wide balancing and settlement code;
   and does not prevent BSCCo performing its other functions under the BSC in accordance with its objectives.