

Workstream Report
Introduction of Two-Thirds Majority Voting to the UNC Modification Panel
Modification Reference Number 0312
Version 0.3

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 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

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

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 under the current voting arrangements that a Modification Proposal can be recommended for implementation provided all Transporter representatives recommend implementation, plus just one Shipper representative (or, all Shipper representatives plus one Transporter representative). Therefore, only a minority of Shipper (or Transporter) support is required for what 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, as they originate not from a signatory to the UNC, but from the Regulator. The effect of two-thirds majority voting is to increase the threat of appeal for Modification Proposals addressing a licence direction. 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 as full a voice as possible, but without creating an unreasonably high hurdle that might lead to filibustering by parties opposed to a change.

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.

The accountability and transparency of the industry code modification process is 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 prejudice, 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. In particular, proposals to give consumer representatives voting rights and Ofgem the power to appoint one of these representatives might be seen to weaken statutory rights of appeal if such parties’ views were to be unduly influenced by those of Ofgem. There is a risk that a party could challenge the legitimacy of Modification Panel recommendations for proposals that originate from an Ofgem SCR, especially if changes to voting rights were to be implemented. The extra safeguard proposed here, of commanding a two-thirds majority, should also help protect Ofgem from potential accusations of prejudgement and any related legal actions.

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;*

The enhanced threat of appeal ensures less inappropriate regulatory interventions. Enhancing regulatory stability by avoiding inappropriate interventions improves confidence in the market, increasing investor confidence and the willingness of parties to enter the market. The effect of this is to improve competition between relevant Shippers.

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.*

Two-thirds majority voting would ensure that materially affected parties have a greater say (compared to the *status quo*) on whether a Modification Proposal originating from a licence condition should be recommended for implementation.

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."*⁴

It is possible, for example, that some Panel members may feel obliged to vote for a proposal originating from an Ofgem initiated process, and it is potential skewing of the Panel vote that this Proposal seeks to address. As a result, the Workstream recognised that the opportunity to appeal could 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. In particular, proposals to give consumer representatives voting rights and Ofgem the power to appoint one of these representatives might be seen to weaken statutory rights of appeal if such parties' views were to be unduly influenced by those of Ofgem. There is a risk that a party could challenge the legitimacy of Modification Panel recommendations for proposals that originate from an Ofgem SCR, especially if changes to voting rights were to be implemented. The extra safeguard proposed here, of commanding a two-thirds majority, should also help protect Ofgem from potential accusations of prejudgement and any related legal actions.

The accountability and transparency of the industry code modification process is enhanced by an effective modification appeals process. By ensuring a slightly higher

⁴ Para 6.192, 'Decision and Order of the Competition Commission', 10 July 2007.

bar to recommend implementation of all Modification Proposals originating from Transporter licence conditions, this can be achieved. In turn, this will enhance the efficiency and effectiveness of the UNC Modification Procedures.

The introduction of the statutory Energy Codes Modification Appeals process was designed to increase accountability for code modification decisions in a proportionate manner. The enhanced threat of appeal created by implementation of this proposal would prevent code issues being repeatedly re-visited (which is inefficient), on the basis that the quality of the final decision by the regulator is better due to increased accountability. The effect is to promote efficiency in the implementation and administration of the uniform network code.

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

Code parties should feel more involved in the consultation and Panel recommendation stage as there is a greater likelihood of minority views being taken into account for what will often be fundamental changes to contractual terms of the UNC.

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 will 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

- A two-thirds majority lends a greater sense of legitimacy to Code Proposals addressing a licence direction, where there is a Panel recommendation to

implement.

- Improved transparency and accountability of the code decision making process.
- Where there is no Panel recommendation to implement a proposal addressing a licence direction, the threat of appeal is increased which has the effect of improving the accountability of the final decision by the regulator. In the view of the Proposer, this is appropriate and proportionate, given that the Proposal effectively originated from the Regulator. The effect should be to help avoid accusations of Ofgem pre-judging the outcome for those Modification Proposals which address a licence direction.

Disadvantages

- None identified

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 was discussed at two 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.