

E.ON UK plc and GEMA and British Gas Trading
Statement of Dame Barbara Mills QC (Chairman of the Group)

10 July 2007

This appeal is concerned with the decision of GEMA to direct the amendment of the Uniform Network Code through modification proposal 116V. That decision was challenged on appeal before us by E.ON, and British Gas Trading intervened in the appeal in the support of E.ON.

During the appeal, we have considered four aspects of GEMA's decision to give effect to modification proposal 116V. First, the user commitment model that 116V would introduce for flat capacity; secondly, the reform of arrangements for the flexibility capacity; thirdly the reform of arrangements for interruptible capacity; and fourthly, GEMA's cost benefit analysis.

Now, E.ON has made numerous criticisms of each of these four aspects of the decision. We have also considered arguments made by E.ON concerning procedural failures in the process leading to GEMA's decision. We make no decision of GEMA's decision in relation to the user commitment model; nor do we accept E.ON's submissions that the process leading to GEMA's decision was flawed.

We have found the decision less satisfactory in relation to interruptible capacity. We have had concerns about the efficiency of this reform in relation to the use of the network on days when there is spare capacity on the NTS. However, our concerns are not such that we can say that GEMA's decision is wrong. That is the test, one might say, in these cases.

There are two important aspects however in which we think GEMA's decision is wrong. These are the proposals for reform of flexibility and GEMA's cost benefit analysis. An important element of the reform of flexibility is that it addresses the risk or the potential risk of future scarcity of flexibility capacity. This is notwithstanding that there is at present no shortage of flexibility capacity. We do not think that it is wrong for a regulator to address risks or potential risks of future scarcity through prophylactic action. We do however think that if GEMA wishes to act now in respect of a risk of future scarcity, it must justify that action in its decision.

In this case it did not do so. GEMA should have set out clear descriptions of the likelihood that there will be a scarcity, of the timescale in which that scarcity will materialise and of the magnitude of the consequences. That decision should have clearly established the factors determining supply and demand of flexibility capacity and the ways in which these may change. We have not decided that GEMA could never reach the conclusion that reform of flexibility capacity is necessary because of the risk of future scarcity. Our conclusion rests on the shortcomings of the decision under appeal.

We also find GEMA's analysis of the benefits that follow from the reform of flexibility unconvincing. GEMA has chosen to rely on the principle of non-discriminatory access to monopoly infrastructure and the pro-competitive benefits of non-discrimination. In a case such as this where competition must take place between regulated and unregulated businesses, it is particularly important that the nature of the competition benefits that accrue from the reform are explained. While non-discrimination and competition are properly described as principles of regulation, we have concluded that if

unmeasurable benefits are taken into account in the cost benefit analysis, those benefits should be clearly and cogently explained.

We have also concluded that GEMA has not established a proper basis on which to exclude transporters' upfront costs of reform from the cost benefit analysis.

We have therefore allowed the appeal in part and we quash the decision to direct the implementation of 116V. In deference to the arguments of the parties on the number of decisions, I should add that insofar as it is necessary for us to do so, we allow the appeal against GEMA's decision not to direct the implementation of modification 116A. However, we do not order that 116A be implemented. The decision therefore falls to be reconsidered by GEMA.