

Modification proposal:	<b>Uniform Network Code (UNC) 324V: (UNC324V) 'Code Governance Review: Significant Code Reviews'</b>		
Decision:	The Authority <sup>1</sup> directs that this proposal be made <sup>2</sup>		
Target audience:	The Joint Office, Parties to the UNC and other interested parties		
Date of publication:	17 December 2010	Implementation Date:	31 December 2010

## Background to the modification proposal

In November 2007 the Authority launched a review of the arrangements for governing the main gas and electricity industry codes, including the Uniform Network Code<sup>3</sup> (the Code Governance Review ('CGR')). The aim of the review was to ensure that those industry codes remain fit for purpose given the wide range of changes that have occurred since the introduction of the codes and given the scale of challenge the industry faces over the coming decade.

The CGR Final Proposals<sup>4</sup> published in March 2010 pulled together various initiatives that had previously been consulted upon through various CGR work strands. Those initiatives seek to make the industry code governance processes more transparent and accessible, particularly to small participants and consumer groups.

The CGR also redefined a role for Ofgem with respect to significant changes to the industry codes, while also allowing us to step back from those parts of the governance arrangements that have minimal impact upon consumers or our wider statutory duties.

The Authority subsequently modified the Standard Conditions of the Gas Transporters (GTs) licence, amongst others, in order to give effect to the CGR Final Proposals. These modifications were made on 5 July 2010, but come into effect on 31 December 2010, allowing licensees opportunity to bring the codes for which they are responsible into line with the modified licence requirements by that time.

## The modification proposal

The proposer, National Grid Gas ('NGG'), raised UNC324 in order to give effect to the Significant Code Review ("SCR") requirements of its GT licence. The proposal provides that where the Authority leads a SCR process and (if the Authority considers it appropriate), directs that a licensee raise a modification proposal to give effect to the Authority's conclusions in areas of work which the Authority considers:

- are of particular significance in relation to the Authority's principal objective, statutory duties or functions or relevant obligations arising under EU law, including in particular:
  - have significant impacts on consumers or competition; and/or
  - have significant impacts on the environment, security of supply or

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

<sup>3</sup> The open letter initiating the Code Governance Review (Doc Ref. 284/07) appears on the Ofgem website: <http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/Open%20letter%20announcing%20governance%20review.pdf>.

<sup>4</sup> [http://www.ofgem.gov.uk/LICENSING/INDCODES/CGR/Documents1/CGR\\_Finalproposals\\_310310.pdf](http://www.ofgem.gov.uk/LICENSING/INDCODES/CGR/Documents1/CGR_Finalproposals_310310.pdf)

- sustainable development; and
- relate to code or cross code or cross licence issues,

the relevant licensee must raise the appropriate modification proposal in accordance with the Authority's direction(s) under the UNC modification procedure.

The Authority would initially consult on whether it is appropriate to progress a particular issue through an SCR process. This would generally be done through the annual Corporate Planning exercise. Subject to the conclusions of this consultation, the Authority may decide to initiate an SCR through a launch statement. This will set out the scope of, the reasons for and the proposed timetable and resources needed to complete the SCR. Following consultation, the Authority would publish its conclusions on the SCR. If appropriate, it may issue directions to the relevant licensees to raise modification proposals giving effect to the SCR conclusions. These modification proposals would subsequently follow the standard change process.

Following the receipt of comments at the UNC Governance Work-stream meeting of 4 October 2010, the proposer requested that their UNC324 be varied in order to provide additional points of clarity<sup>5</sup>. Thereafter, UNC324 was deemed withdrawn, to be replaced by UNC324V, which was itself consulted upon.

### **UNC Panel<sup>6</sup> recommendation**

At the Modification Panel meeting held on 18 November 2010, the Panel determined by a majority that the proposal be implemented.

### **The Authority's decision**

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 6 December 2010. The Authority has considered and taken into account the responses to the Joint Office's consultation on the modification proposal which are attached to the FMR<sup>7</sup>. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the UNC; and
2. directing that the modification be made consistent with the Authority's principal objective and statutory duties<sup>8</sup>.

### **Reasons for the Authority's decision**

We note that the majority of respondents also consider that UNC324V will better facilitate relevant objectives (c) and (f). Of the ten respondents to the Joint Office's consultation, nine were in favour, though two of those had provided comments on the original proposal and not on the subsequent variation. However, the respondent who was opposed suggested that the SCR process could be detrimental to competition. We have therefore addressed their comments under relevant objective (d) below.

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<sup>5</sup> <http://www.gasgovernance.co.uk/sites/default/files/0324%20v%20Variation%20Request.pdf>

<sup>5</sup> UNC modification proposals, modification reports and representations can be viewed on the Joint Office of Gas Transporters website at [www.gasgovernance.com](http://www.gasgovernance.com)

<sup>6</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

Our reasons for introducing the SCR process were set out in full in our CGR Final Proposals and are not repeated here. The pertinent matter for this decision is whether UNC324V better meets the relevant objectives of the UNC, including but not limited to the efficient discharge of the licensee's obligations under its licence. We anticipate that this modification, introducing the SCR process, will lead to the successful and timely implementation of modifications that improve the promotion of efficiency in the implementation and administration of the UNC and facilitate competition. However, we do not consider that it is appropriate to anticipate the benefits of those future proposals and attribute them directly to this decision. We agree with the proposer that UNC324V better meets relevant objectives (c) and (f) of the UNC and also consider relevant objective (d) and the requirements of paragraph 9 of standard special condition ('SSC') A11 are better facilitated by this proposal

***Relevant Objective (c): so far as is consistent with subparagraphs (a) and (b) the efficient discharge of the licensee's obligations under its licence.***

The Gas Transporters must ensure that the UNC modification procedures provide for a mechanism by which a licensee can make a modification proposal in accordance with a direction(s) by the Authority pursuant to an SCR and not withdraw that proposal without the Authority's prior consent. They must also provide for the proper evaluation of the suitability of the SCR route for particular modification proposals raised once an SCR has formally commenced and non-urgent modifications falling within scope of an ongoing SCR should not normally proceed along usual code development processes<sup>9</sup>. We consider that the proposal improves consistency of the modification rules with these licence requirements.

Whilst noting that there are outstanding issues in relation to the legal text accompanying this proposal (see below), we consider that this proposal improves alignment of the UNC modification procedures with the licence requirements set out above, which also incorporate the principles of the Code Administration Code of Practice, as compared to the baseline and therefore does better facilitate efficient discharge of NGG's licence obligations as compared to the baseline. We also note that National Grid has, in its letter of 15 December 2010<sup>10</sup> set out a process for dealing with the outstanding legal text issues through a further modification proposal.

***Relevant Objective (d): so far as is consistent with subparagraphs (a) to (c) the securing of effective competition.***

The one respondent who was opposed to the implementation of UNC324 recognised the potential benefits to transparency and an efficient decision making process. However, they were concerned that the SCR process could be detrimental to competition. They suggested that it could result in Ofgem driving inappropriate solutions, particularly if a licensee directed to raise an SCR modification proposal does not possess the appropriate expertise. They also considered that the SCR may stifle the timely development of alternative options put forward by industry, as they will be subsumed by the SCR process and that this limitation may impinge upon the quality of decision making.

The same respondent went on to suggest that their view might change if there was both a higher threshold of support required for a Panel recommendation on an SCR proposal

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<sup>9</sup> Paragraphs 9(b)(i), (9)(da), 10(aa), (15A), (15B) and (15C) of standard special condition A11 of the gas transporters licence.

<sup>10</sup> See: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=372&refer=LICENSING/INDCODES/CGR>

and a time limit on how long an industry proposal could be suspended during an SCR. Another respondent, while supporting the implementation of UNC324V, similarly suggested that further check and balances should be provided within the SCR process.

We consider that some of the comments raised in relation to UNC324V have already been aired and appropriately addressed. We have acknowledged in our CGR final proposals that to the extent that parties believe that further checks and balances are needed in relation to SCR modification proposals it may be possible to pursue them through changes to the modification rules. We note that Ofgem would retain an open mind throughout the process and that the Authority would ultimately make decisions on modification proposals according to its statutory duties.

We also consider that any concerns around asymmetries of information and knowledge must also apply to the existing modification process, which is why the modification rules allow for development and assessment by a much wider pool of expertise than may be available to the proposer. Nothing in the SCR process prevents such development appropriately being carried out, or an alternative proposal being raised if it is considered to better facilitate the relevant objectives than the baseline and the original proposal.

Further, we consider that the SCR process will be beneficial rather than detrimental to competition. As already mentioned, we do not intend to attribute the benefits of future proposals to UNC324V, though we certainly expect many of them to have direct and indirect benefits to competition. However, the SCR process introduced by UNC324V will of itself increase transparency and certainty rather than reduce it. As noted by one respondent, the matters which are likely to be reviewed as part of an SCR process would in any case have fallen under our regulatory purview and may instead have been pursued through modifications to licences for instance. Many of the inefficiencies and delays associated with the existing processes can be avoided through the SCR process.

It has been suggested that the ability to subsume modification proposals may stifle innovation and limit the options which feed into our decisions. However, we consider that the intent of subsuming proposals is that they may instead be taken forward and considered as part of the SCR process, not simply 'suspended'. Such proposals could therefore feed into and have greater influence on the thinking which leads up to SCR conclusions than may be the case if they were allowed to progress along an entirely separate route. Further, this will prevent the duplication of effort and potential waste of industry resources on proposals which may already, or shortly afterwards, be superseded. However, we do agree that it would be inappropriate to prevent proposals from being progressed for an indefinite or prolonged period. We have stated that we anticipate the initial phase of an SCR (the period leading up to a modification proposal being raised) to last no more than 12 months, though the actual timetable will be determined by the circumstances of the SCR and a proposed timetable will be set out in full in the launch statement. We have also made clear that any modification which is considered to be too urgent to await the outcome of the SCR may be exempted by the Authority and progress along its own timetable, as appropriate.

We consider that a holistic consideration of issues through a SCR as proposed in UNC324V is more likely to lead to solutions which have a beneficial impact on competition, where appropriate, rather than the current piecemeal approach to code changes. Therefore we therefore consider that the implementation of this proposal would also better meet objective (d).

***Relevant Objective (f): the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code;***

One of the respondents suggested that although they considered it was self evident that implementation of UNC324V would better facilitate relevant objective (c), they would not have supported the proposal on that basis alone; they supported the proposal as they considered it would better facilitate relevant objective (f). They considered that the SCR process will allow issues with a broad and potentially significant material impact on industry participants to be considered in a holistic manner without individual parties' commercial interests dictating a piecemeal approach to the solution. We agree with this view on better facilitation of this relevant objective.

***Paragraph 9 of SSC A11***

Paragraph 9 of SSC A11 sets the minimum requirements for the UNC change management process. Particularly paragraphs 9(b)(i) and (9)(da) require the UNC modification rules to provide for the making of proposals via the SCR route and proper evaluation of the suitability of the SCR route for modification proposals by assessment against the SCR criteria. We consider that this proposal improves consistency between the UNC modification procedures and the requirements of SSC A11.

***Consolidated suggested legal text***

We note that NGG has produced consolidated legal text covering all of the CGR related proposals. This is to help others understand how the code rules will look if we were to direct implementation of all of the proposals (and not their alternatives where applicable). We consider this has been helpful. We also note that if NGG consider the consolidated text accurately reflects all of the CGR related proposals and we direct implementation of all of the CGR related proposals and not their alternatives where applicable, NGG/the Joint Office may choose to implement using the consolidated text.

We have raised a number of issues with NGG regarding compliance of certain aspects of the legal text for this proposal with requirements of standard special condition A11 in NGG's licence. We note NGG's letter of 15 December 2010<sup>11</sup> which sets out a process for dealing with the outstanding legal text issues through a further modification proposal. We note that NGG will meet with Ofgem to review the outstanding comments and gain a common understanding of the further change required. We consider that this is an appropriate way forward.

**Decision notice**

In accordance with Standard Condition A11 of the Gas Transporters Licence, the Authority, hereby directs that modification proposal UNC324V: Code Governance Review: 'Significant Code Reviews' be made.

**Mark Cox**

**Associate Partner, industry Codes and Licensing**

Signed on behalf of the Authority and authorised for that purpose.

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<sup>11</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=372&refer=LICENSING/INDCODES/CGR>