

Modification Report
Introduction of Two-Thirds Majority Voting to the UNC Modification Panel
Modification Reference Number 0312
Version 2.0

This Modification Report is made pursuant to Rule 9.3.1 of the transitional Modification Rules and follows the format required under Rule 9.4.

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 shall apply for the purposes of the Panel determination as to whether to recommend implementation.

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

² Para 6.192, 'Decision and Order of the Competition Commission', 10 July 2007.

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 that a Modification Proposal can currently be recommended for implementation provided all Transporter representatives recommend implementation, plus just one Shipper or consumer representative (or all Shipper representatives plus one Transporter or consumer representative), despite the fact that the proposal 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, since they originate not from a signatory to the UNC, but from the Regulator. 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 their views seen to be taken into account in the decision making process, but without creating an unreasonably high hurdle that might lead to filibustering by parties opposed to a change.

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 prejudge, 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. The extra safeguard proposed here, of commanding a two-thirds majority, should also help protect Ofgem from potential accusations of pre-judgement.

2 User Pays

a) **Classification of the Proposal as User Pays or not and justification for classification**

No User Pays service has been proposed or amended 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.

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.

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 Workstream accepted that it could be argued that, as an independent regulator, Ofgem is still an administrative body of government and independence does not mean that the regulator should function in a vacuum. Accordingly, its actions should be monitored so that it is fully accountable for those actions. To help facilitate accountability, a system of 'checks and balances' is required. The main check currently on substantive decisions by Ofgem comes from the ability of companies to appeal to the Competition Commission. This process allows Code Modification decisions to be independently reviewed, thereby preventing the concentration of powers in a single body (Ofgem). Some Code parties have raised concerns that the proposed SCR process may result in insufficient separation of powers (i.e. Ofgem effectively acting as "judge, jury and executioner") for the purposes of industry Code governance. Therefore, to maintain balance and to ensure effective separation of powers, the new powers for Ofgem to effectively originate Modification Proposals under SCRs means that the process for arriving at a Panel recommendation must change in response, by introducing a slightly higher hurdle in order to maintain the efficacy of the statutory Energy Code Modification appeals process as envisaged by Parliament.

By reinforcing the concept of separation of powers and maintaining an effective appeals mechanism, the intended effect of the proposal is to protect the open and participatory regulatory decision-making process, where industry participants believe

that regulatory decisions take their interests into account. This, in turn, may be expected to provide confidence in the regulatory system from justice “being seen to be done”, which may ultimately attract new entrants to the market or improve competition between existing Shippers.

Consumer Focus agree in principle that competition may be better facilitated by making it easier to appeal decisions prompted by Significant Code Reviews but only if this is delivered through the appropriate procedural means, which is by the Secretary of State revising his description of those decisions eligible for appeal (i.e. revising the appropriate Statutory Instrument). Consumer Focus consider that this proposal seeks to circumvent the appropriate statutory process. They are sceptical that gerrymandering the application of a statutory instrument is legally viable, and are worried that there is scope for considerable unintended consequences if a judgement call is taken that it is (i.e. it would set a precedent that industry codes can be used to unwind, or materially alter the application of, legislation). Because of these concerns, Consumer Focus think this proposal is as likely to reduce regulatory certainty as increase it; Consumer Focus do not consider that it better facilitates competition.

National Grid agrees that the Proposal has the intention of making it harder for Ofgem to avoid the right of appeal in relation to Modifications which have originated with them. This may be viewed as “fair” and consequently make the market more attractive to competition. They remain to be convinced however that it will have any significant effect.

Northern Gas Networks do not agree that implementation would better facilitate the achievement of this relevant objective.

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.

The Workstream accepted that it could be argued that requiring a higher (two-thirds) threshold of support to achieve a Panel recommendation could itself act as an incentive for the proposer, Regulator and wider industry to co-operate on Licence direction originated proposals, ensuring as far as possible that a proposal has a broad level of industry support. Failure to achieve a broad level of industry support will almost certainly result in a failure to achieve a recommendation to implement by the Panel (which acts as a filter for appeals broadly based around industry consensus).

This in turn opens up the potential for affected parties to access the Competition Commission appeal mechanism if Ofgem were to subsequently disagree with the Panel's majority view. Ensuring that Licence direction driven proposals reflect broad industry consensus should result in fewer subsequent regulatory interventions or issues being re-visited, which may be considered to better facilitate the relevant objectives in terms of promoting efficient administration of the UNC.

Implementation would similarly facilitate paragraph 9 of SSC A11, as required for changes to the UNC Modification Rules.

Consumer Focus is not convinced this objective is either facilitated or impeded by this proposal. We recognise the argument that industry (and by extension, consumers) time and money can be saved where consensus decisions can be found that are not endlessly revisited, disputed or tweaked by subsequent modifications. But Consumer Focus think that SCR-prompted modifications, pretty much by definition, are never going to be consensus decisions regardless of where the appeals eligibility threshold is set – because they are inherently likely to be highly material and therefore create pronounced winners and losers. Changing appeals eligibility isn't going to make SCRs a straightforward consensual process; this proposal wouldn't hurt, but it wouldn't help either.

National Grid Distribution argue it is difficult to see that this Proposal will have any significant impact on this objective. It can be argued that the Proposal, if implemented, will increase the complexity of the governance arrangements and consequently have a negative impact.

National Grid Transmission do not see the benefit of introducing additional complexity and processes to the UNC and therefore disagree that this proposal promotes efficient administration of the UNC or secures effective competition.

Northern Gas Networks do not agree that implementation of the modification would better facilitate the achievement of this relevant objective.

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:

No such consequence is anticipated.

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 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

The intent of the proposal is to protect the open and participatory regulatory decision-making process, where industry participants believe that regulatory decisions take their interests into account. The Workstream believes that this may improve confidence in the Code governance process and effectiveness of the overall regulatory regime. This may serve to enhance confidence in the market for any industry participant or affected party.

Consumer Focus pointed out that the impacts and costs of this proposal lie less in what it does in isolation but in the broader precedent it would create that the application of statutory instruments could be materially unwound or altered by industry codes.

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 may be considered to 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

- The key advantages of implementation are set out in Section 3, above.

Disadvantages

- By introducing new rules, the proposal may be considered to add some additional complexity to the existing governance process.

12 Summary of representations received (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

Company/Organisation Name	Support Implementation or not?
Association of Electricity Producers	Support
British Gas Trading	Support
Consumer Focus	Not in support
E.ON UK	Support

National Grid Distribution	Comments
National Grid Transmission	Not in support
Northern Gas Networks	Not in support
RWE npower	Support
ScottishPower	Support
Scottish & Southern Energy	Support
Wales & West Utilities	Not in support

In summary, of the eleven representations received, 6 supported and 4 opposed implementation, and 1 provided comments.

The Association of Electricity Producers believe implementation of the modification would introduce additional checks and balances within the governance processes whilst separating out Ofgem's roles as potential initiator of Significant Code Reviews and being the ultimate decision maker on UNC modifications. They note that maintaining an appropriate appeals mechanism provides for scrutiny of contentious proposals.

British Gas Trading point to the tension between a Transporter being instructed to raise a UNC proposal as part of a SCR process, and an expectation that as the proposer they would naturally support its implementation. In their view, this modification provides a check and balance to avoid Ofgem exerting inappropriate influence in the UNC processes, effectively raising the bar for Panel decisions.

Consumer Focus summarise that the Energy Act 2004 is quite clear that the right to designate which codes, and which decisions on those codes, are eligible for appeal rests with the Secretary of State alone.

E.ON UK note that legal advice was provided for CAP 190 under the CUSC and P264 under the BSC as a result of concerns that those proposals may not be implementable (or ineffectual) if they conflicted with the statutory instrument which gives rise to the right of appeal. The advice noted that the word "majority" is capable of meaning "two thirds majority" for the purposes of interpreting the meaning of the relevant statutory instrument. Furthermore, the QC's advice was that it would be possible to raise the threshold required by the BSC or CUSC for a Panel to recommend a particular amendment/modification. The threshold could be raised to a requirement for a two-thirds majority.

National Grid Distribution commented that the modification may not achieve its objective in all eventualities. Furthermore, they believe that a right of appeal would need to exist for modifications implemented where a UNC Panel two-thirds majority vote was not achieved and ultimately the right of appeal rests with the Competition

Commission who may choose to place their own interpretation upon the term 'majority', implying that this modification may have little effect on their decision. This view is also supported by National Grid Transmission who state that there has been differing legal advice received for the similar modifications raised for BSC and CUSC and there is still continued uncertainty as to whether the Competition Commission would recognise the proposed changes to the way a Panel Majority is determined as part of the Panel recommendation to implement a proposal.

RWE npower point out that they would have liked to have seen more detailed analysis undertaken and results published, in order that no uncertainty remains around the validity of the modification.

Wales & West Utilities suggest that the modification proposal is based on the supposition that the Gas Transporters may not act in a reasonable manner when directed to raise a modification proposal as a result of a Significant Code Review, and disagree entirely with this. Wales & West Utilities believe the statutory instrument is clear in its intent and to manipulate this by way of a change to the UNC modification rules is not appropriate. As the Statutory Instrument can be amended, they believe that this would be the most appropriate route to tackle this issue.

13 The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

Implementation is not required to enable each Transporter to facilitate compliance with safety or other legislation

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)

Immediate implementation is proposed.

Consumer Focus suggest that, in the interests of running an orderly market, it would be appropriate to co-ordinate the timing of any implementation such that this aligned with any changes to the BSC and CUSC.

E.ON UK would welcome a speedy decision on this modification and oppose waiting for the similar electricity code modifications to run their course.

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 Recommendation regarding implementation of this Modification Proposal and the number of votes of the Modification Panel

The Panel Chair summarised that the modification seeks to introduce a higher threshold when the Panel determines whether or not to recommend implementation of a modification that is related to a Significant Code Review.

To the extent that a Panel recommendation influences the decision whether or not to implement a modification, this may provide an additional check on regulatory decisions, which some Panel Members consider would increase market confidence and so be consistent with facilitating effective competition. Some Members also expected the higher threshold to impact the option to appeal modification decisions to the Competition Commission, which would similarly have the potential to increase market confidence.

Other Members were not convinced that the change in threshold would have any material impact, and noted that the Competition Commission may have no regard to the changed threshold in deciding whether or not an Appeal is valid. In any event, some considered it would not be appropriate to try to use the rules in an industry code to circumvent the Statutory Instrument governing Appeals. As such, implementation would be inconsistent with facilitating efficiency in the implementation and administration of the UNC. Some Members also felt that this relevant objective would be adversely impacted since the modification would increase complexity in the governance process. However, other members felt that creating a more appropriate threshold would be consistent with facilitating efficient implementation of the UNC, with more robust decision making resulting from implementation.

With five out of a possible eleven votes cast in favour, Panel Members did not determine to recommend that Modification 0312 should be implemented.

The benefits against the Code Relevant Objectives	
Description of Relevant Objective	Identified impact
a) Efficient and economic operation of the pipe-line system.	None
b) Coordinated, efficient and economic operation of (i) the combined pipe-line	None

<p>system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters.</p>	
<p>c) Efficient discharge of the licensee's obligations.</p>	None
<p>d) 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.</p>	Positive
<p>e) Provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards... are satisfied as respects the availability of gas to their domestic customers.</p>	None
<p>f) Promotion of efficiency in the implementation and administration of the Code</p>	Negative

19 Transporter's Proposal

This Modification Report contains the Transporter's proposal to modify the Code and the Transporter now seeks direction from the Gas and Electricity Markets Authority in accordance with this report.

20 Text

Legal Text

MODIFICATION RULES

Amend paragraph 2.1 to read as follows:

““**Panel Simple Majority**”: subject to paragraphs 9.3.15 and 9.3.16, in relation to any matter to be determined at a quorate and duly convened meeting of the Modification Panel:

- (a) a majority ... such matter; or
- (b) if there is an equal number ... such matter;”

Amend paragraph 5.1.2 to read as follows:

“5.1.2 Except as otherwise permitted in these Rules:

- (a) determinations of the Modification Panel shall be made by Panel Simple Majority; and
- (b) Workgroups (other than a NTS Charging Methodology Forum and a DN Charging Methodology Forum) may be created or dissolved by a Panel Simple Majority”.

Amend paragraph 9.3.3 to read as follows:

“9.3.3 Upon receipt of the final Modification Report under paragraph 9.3.1 or 9.3.2 the Modification Proposal shall assess whether the final Modification Report complies with paragraph 9.4, and if it is compliant, shall:

- (a) subject to paragraph 9.3.15 and 9.3.16, determine whether or not to recommend the implementation of the Modification Proposal to the Authority;
- (b) submit ...or not; and
- (c) instruct ... Administrator.”

Add new paragraph 9.3.15 to read as follows:

“ 9.3.15 Any determination of the Panel pursuant to paragraph 9.3.3 (a) on whether or not to recommend the implementation of:

- (a) a Significant Code Review Modification Proposal; or
- (b) any other Modification Proposal arising from a Significant Code Review; or
- (c) any alternative Modification Proposal to a Modification Proposal referred to in paragraph (a) or (b);

shall be made by a two thirds majority of the votes cast at the Panel Meeting.”

Add new paragraph 9.3.16 to read as follows:

“9.3.16 Where any person invited by the Secretary to make representations, makes a representation that any Modification Proposal addresses the same requirements (in whole or part) as a Significant Code Review Modification Proposal then the Panel shall determine by a Panel Simple Majority whether such Modification Proposal does address such requirements and where the Panel determines by a Panel Simple Majority that it does so then the determination under paragraph 9.3.3 (a) in respect of such Modification Proposal shall be made by a two thirds majority of the votes cast at the Panel Meeting.”

For and on behalf of the Relevant Gas Transporters:

Tim Davis
Chief Executive, Joint Office of Gas Transporters