

Industry Codes Workgroup, 20 October 2005 – Discussion Document

The purpose of this document is to review, at a high level, the existing arrangements for establishing, maintaining, signing and complying with the various industry codes which impact on suppliers as part of the standard conditions of gas and electricity supply licences. It also provides a number of broad questions and options for discussion at the Industry Codes workgroup on 20 October 2005. As such this document does not represent the formal views of the Authority. As a general observation there are variations between the requirement to establish, maintain, sign and comply with codes. There are also other marked variations between codes for example; some agreements are standard across the whole market whilst some agreements are specific to certain electricity distribution network operator (DNO) or gas distribution network (DN) areas. Additionally, some of the codes are signed up to on a multilateral basis whilst others are signed up to on a bi-lateral basis, typically between an individual supplier and an individual DNO or DN.

In determining the scope of the Supply Licence Review (SLR) Ofgem consulted upon and agreed a number of principles. Whilst other principles may be relevant, Principle 3 directly referred to industry codes and set the expectation that:

“Licence conditions that relate to compliance with industry codes and agreements are only likely to be necessary if they do not themselves contain adequate sanctions for suppliers who breach them.”

Establishing and Maintaining Codes

The licence framework typically requires the establishment and maintenance of gas and electricity industry codes that are essential to the operation of the gas and electricity markets. The requirement for the majority of codes to be established and maintained is set in the electricity distribution, generation and gas transporter licence, for example with the Master Registration Agreement (MRA), Balancing and Settlement Codes (BSC) and Uniform and ‘short-form’ Network Codes respectively. However, the supply licence can also contain a requirement to establish and maintain industry codes as is the case with the Supply Point Administration Agreement (SPAA) in the gas market.

Questions:

Q1: What purpose does requiring a supplier to establish and maintain an industry code through the licence serve?

Q2: What are the characteristics of codes that require suppliers to establish and maintain an industry code as a condition of the licence?

Q3: Are there alternative mechanisms to ensure that, where required, suppliers establish and maintain industry codes?

Signing Industry Codes

Gas and electricity suppliers currently sign up to a number of industry codes. Some of these are signed as a requirement of the standard conditions of supplier’s licences. Examples of such codes are the BSC, CUSC, and the MRA in the electricity market and the SPAA in the gas market. Typically these codes set out requirements for

interoperability and/or securing of standards that have not been (or may not be able to be) sufficiently secured through normal contractual arrangements.

Other industry codes are not signed up to as a licence requirement, for example the Distribution Use of System Agreement (DUoS) in the electricity market and Network Codes in the gas market. With such codes there may be strong commercial reasons for the supplier (or their shipper) entering into the agreement in order to access and operate in the market. Suppliers may also have a de facto requirement to enter into an agreement to be able to trade that secures compliance against other obligations – for example shippers and Network Codes.

Questions:

Q1: What purpose does requiring a supplier to enter in an industry code through the licence serve?

Q2: What are the characteristics of codes that require suppliers to enter into the agreement as a condition of the licence?

Q3: Are there alternative mechanisms to ensure that suppliers enter into agreements?

Compliance with Industry Codes

Suppliers require clarity of the regulatory risk posed by non-compliance with the agreements that they are required to adhere to under the conditions of their licence. Clarity of understanding also provides advantages for customers in knowing when action is likely to be taken and by whom.

Where suppliers are required to sign an industry code under the licence they are also required to comply with the code. Such codes may have internal compliance arrangements, such as BSC Performance Assurance Framework, which seek to secure compliance but the Authority will further have the ability to enforce compliance. It is Ofgem's view that non-compliance issues identified by code parties should first be tackled through the code's internal compliance arrangements where such arrangements exist. Ofgem's role in enforcing will be activated where these internal arrangements have failed. Alternatively, Ofgem may seek to investigate directly where a complaint is received by a customer who does not have access rights to the code's internal compliance arrangements. It is for debate whether the Authority should /could investigate non-compliance issues where these are subject to internal industry code compliance arrangements or whether customers could have direct access to the industry's self-governance arrangements.

Codes that suppliers are not required to sign and comply with pursuant to their licences may include their own provisions to secure compliance. Compliance may for example be sought through self regulation e.g. liquidated damages, withdrawal of services or other commercial arrangements or, as with the Network Code, a more general requirement (on the shipper in this instance) not to knowingly or recklessly prejudice the safe and efficient operation of the network. In the last example, where the Authority determines that obligations not to interfere with the network are being breached then enforcement action can be taken.

Questions:

Q1: What purpose does requiring supplier to comply with an industry code through the licence serve?

Q2: What are the characteristics of codes that require suppliers to comply with the agreement as a condition of the licence?

Q3: What should the role of the Authority be in enforcing compliance with industry codes?

Q4: Are there alternative mechanisms to deliver compliance with industry agreements?

Alternative Compliance Arrangements

There are a number of potential compliance models. These include:

Option 1: Formal regulation only. In this model suppliers are required to sign and comply with the code as a condition of supply licence. The Authority would investigate potential breaches of the code or set out its reasons for not doing so. The Authority is likely to be made aware of a potential breach through a complaint from a customer or industry party or from internal monitoring. This code does not contain internal compliance arrangement but is fully reliant on commercial incentives and enforcement by Ofgem. There are 2 further subcategories to this option:

- a) The Authority would be required to investigate and seek enforcement for all potential breaches of a code.
- b) The Authority would be required to investigate and seek enforcement in relation to a general obligation not to disrupt the smooth operation of the market, including material breaches of a code.

Option 2: Self-regulation where possible licence enforcement where not. Under this model suppliers would be required to sign the code as a condition of their supply licence. The provisions of the code would allow for compliance arrangements but would require/allow breaches to be referred to the Authority where the breach had not been rectified in accordance with the code arrangements. The Authority is likely to be made aware of a potential breach through a complaint or where the internal compliance arrangements for the code have been exhausted. As with the above option, there are 2 further subcategories to this option:

- a) The Authority would be required to investigate and seek enforcement for all potential breaches of a code.
- b) The Authority would be required to investigate and seek enforcement in relation to a general obligation not to disrupt the smooth operation of the market, including material breaches of a code.

Option 3: Self-regulation only. In this model compliance is not secured directly through the licence. Enforcement could be considered through internal compliance measures in the code or through general contract law.

Option 1b and 2b attempt to reflect the requirement for suppliers to comply with the spirit of the agreements. However, it recognises that there may not be benefits in suppliers being subject to the risk of regulatory enforcement action for smaller technical breaches that do not have a material impact on the market. Under such an approach a definition of “material” would need to be considered.

There may of course be further options and hybrids of the above models and these should be developed for further discussion. Once the options have been identified, the advantages and disadvantages of each approach can be assessed.