

SLR Industry Codes Workgroup  
**Summary Ofgem Response to Npower/EDF paper: Compliance with  
the Industry Codes and Agreements**

**Paper 03/02, 19 January 2006**

To assist discussion by the Industry Codes Workgroup, this paper sets out a summary of Ofgem's initial views on the straw man proposal prepared by Npower and EDF. Included are a set of issues and concerns that the workgroup may like to give consideration to addressing.

The essential components of the proposed model are:

- Removal of duplication of enforcement processes
- Ofgem enforcement by invitation only
- Ofgem enforcement restricted to certain predetermined areas
- Illustrative legal drafting.

These elements are addressed in turn below.

**Removal of duplication of enforcement processes**

Ofgem acknowledges the concerns expressed on this subject. However, as a matter of policy, Ofgem has elected not to pursue enforcement action in relation to industry codes where a non-compliance is being dealt with by self-governance arrangements. Ofgem questions whether the two consequences referred to in paragraph 3.3 are inevitable as they have not occurred to date through adherence to this policy.

**Ofgem enforcement by invitation only**

Ofgem recognises the merit in the formal definition of Ofgem's enforcement powers in relation to industry code compliance. It does not disagree with the principle behind this proposal.

It does have some concerns about some of the detail of how this proposal would operate that the workgroup may seek to address as the proposal is developed further. These are:

1. Panels and committees responsible for compliance sanctions should be of sufficient competence, standing and independence that they are able to discharge compliance-related duties effectively. Consideration needs to be given as to the appropriate make up of such bodies such that their decisions are considered to be robust and they are trusted to review and collect market-sensitive data.
2. Parties to the industry codes should have an appeal mechanism in respect of decisions where the process followed by the panel or committee is flawed. Such

appeals should be considered by a separate authority (for example, Ofgem although other forms of arbitration may be practical).

3. Such a formal restriction of the supply licence obligation would create an inconsistency with other types of licence. This could create inequities in the way non-compliances are dealt with, particularly where holders of different licence types are party to the same agreement but subject to different compliance obligations.
4. Objective triggers should be included in assessing escalation and compliance sanctions and ultimate referral to Ofgem.
5. Careful consideration should be given to non-compliances that directly affect non-code parties, particularly customers, and how these can be enforced without detriment to the protection afforded to them. Again, the obvious example that we keep returning to is the use of the objections mechanism.
6. Sanctions should escalate in severity but be proportionate to the offence.
7. Would a reduction in the presence of Ofgem as a competition authority in the compliance arrangements increase the exposure of committees or panels to wider competition considerations or legislation?
8. Ofgem agrees with the points raised under paragraph 8.2 concerning the measures on which the proposed approach is dependent. Ofgem notes that, for the first bullet in particular, experience under the BSC suggests that the development of progressive, proportionate and (crucially although not mentioned explicitly mentioned) effective sanctions in all industry codes is likely to be a significant challenge for the industry.

### **Ofgem enforcement restricted to certain predetermined areas**

Ofgem has concerns about 'crystal ball gazing' in setting out the areas in which it could be called upon to enforce non-compliance. It considers that such a process may be difficult to carry out and at the same time build confidence that the list of predetermined areas is exhaustive and appropriate.

As an example of Ofgem's concerns in this area, one of the key objectives of the BSC is to facilitate effective competition in supply. The Code and its subsidiary documents contain an enormous number of requirements and performance measures, the majority of which seem unlikely to be the sort of areas that would qualify among the predetermined areas proposed<sup>1</sup>. If there were to be significant and persistent non-compliances, even in the areas of the Code considered to be of less relevance to the regulator, this could have an impact on the operation of the Code overall and its facilitation of its objective to promote effective competition in supply. In such cases, the inability for Ofgem to take any action, even after the conclusion of industry initiatives, due to the fact that the non-compliance was in an area initially not considered to be of regulatory interest could have significant implications for achievement of Ofgem's

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<sup>1</sup> The proposal suggests that the predetermined areas are likely to be limited to areas of particular interest to Ofgem due to their 'customer facing' nature or other sensitive considerations such as security of supply, public safety or environmental impact.

statutory duties. In short, non-compliances in any area of industry codes may be of regulatory interest if they are sufficiently material.

More work would need to be done in defining appropriate predetermined areas in order to give Ofgem comfort that a role in their enforcement was no longer required.

### **Illustrative legal drafting**

Ofgem finds the illustrative legal drafting very helpful in representing how the proposal might work.

It does note that the current obligations that relate to the various industry codes are not necessarily consistent and that a more complex treatment of them may be required if the differences are to be maintained in any new licence condition. For example, there are obligations relating to the CUSC and the BSC not to frustrate or unduly delay implementation of approved changes to those agreements<sup>2</sup> while there is no such obligation in relation to the MRA. In addition, some conditions contain provisions which are not obligations but which are relevant only to certain industry codes – for example, the Authority may relieve the obligation to comply with the relevant Distribution Codes and Grid Code by direction. The Industry Codes Workgroup will need to consider these additional elements and obligations and, if they are to be changed or removed, provide sufficient justification. If they are not to be changed or removed, they will need to be captured in the final legal drafting.

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<sup>2</sup> SLC 9 and 11