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Review of Industry Code Governance

The multilateral codes that govern participation in Great Britain's gas and electricity sector have a significant impact upon participants. As such their relevance, robustness and inter-relationship is a critical element in facilitating an effective and efficient market and in shaping the development of the gas and electricity sectors.

We welcome Ofgem's intention to initiate a project that reviews the governance regime. Reform of the existing frameworks is necessary. It is timely that such reform should be considered, in order to ensure consistency with the major legislative changes planned for 2008 in the energy arena.

Since the major Codes were originally designated, there have been significant structural changes in the markets and statutory changes to the regulatory framework within which the codes reside, notably the development of the principles of better regulation.

Code development has, in some cases, proceeded in the past without a full consideration of internal consistency/relevance or taking sufficient cognisance of other Codes/agreements that have a material bearing on the matters in question.

We agree with Ofgem's objectives for the reformed governance regime, namely it should:

- promote inclusive, accessible and effective consultation;
- be governed by rules and processes that are transparent and easily understood;
- be administered in an independent and objective fashion;
- provide rigorous and high quality analysis of the case for and against proposed changes;
- be cost effective;
- contain rules and processes that are sufficiently flexible to circumstances that they will always allow for efficient change management; and
- be delivered in a manner that results in a proportionate regulatory burden.

We would suggest that the objectives also need to include:

- Timeliness in the consideration and implementation of changes, both now and as a continuing priority - especially the deliberations of Ofgem
- A clear and specific definition of the role and responsibilities of Ofgem in the overall Industry Governance structure, including a comprehensive statement by Ofgem on how they weight/prioritise their responsibilities in specific areas - and how this in turn will reflect in the implementation of their duties and decision making. Industry will therefore have greater clarity on the process and an assurance of consistency of outcome, which does not currently exist.
- A full definition from Ofgem of the minimum standards/requirements stakeholder governance related matters must meet when presented for deliberation/decision
- The development of appropriate and effective cross-code amendment *and optimisation* processes
- Provision and maintenance of an appropriate balance between the interests of the various stakeholders in the process
- Consistency in the treatment and consideration of proposals across the various governance regimes. Dependent on the issues being considered, Ofgem may find itself in the role of consumer protector, proxy for insufficient [or no] competition or environmental policy promoter. Treatment of [e.g.] BSC or CUSC proposals should not be open to consideration based upon a [potentially arbitrary] changing prioritisation of responsibilities but should be based on an objective and consistent framework

Ofgem's Role in the Process

Ofgem has a unique position in being able to assess the desirability of change, or the importance of a particular issue across the whole suite of Industry Governance and processes. There is a role for Ofgem in more actively identifying and promoting change where the industry has brought forward proposals for reform. Currently, Ofgem's involvement is towards the end of any change process, where proposals are presented for decision or review. The recent examples of the ARODG process and the ongoing cashout review, where Ofgem has been proactive in facilitating change provide a template which could usefully be developed further. However, experience has been mixed. The TADG process did not deliver sufficient value for stakeholders, due to Ofgem's reluctance to engage with the issues identified by the TADG report, and stakeholder concerns.

Ofgem could usefully provide assistance and guidance to help shape reform proposals at an earlier stage. This would promote efficiency and better quality proposals being presented for decision.

Issues for Consideration

The rules for how modification proposals must be assessed vary from code to code, as does the extent to which changes are subject to self-determination by the industry or must be referred to Ofgem for decision.

- There is merit in examining what benefits could be derived from more harmonisation of modification rules across the various codes

The Energy Act ensured that Ofgem decisions/determinations are made within the context of a right of appeal to the Competition Commission, and better regulation duties on the Authority.

However, since the code modifications process means that a significant part of the process rests with industry and the code panels, the ability of Ofgem to reach an optimal decision on any given proposal, necessarily varies with the process.

- Ofgem needs to ensure that the Code modifications process[es] deliver optimal information and analysis for robust decisions to be made

The ability of participants to influence outcomes is related to size and availability of resource, regardless of the merits of a particular proposal. Some governance processes are endowed with more resource than others. Whilst the availability of abundant resource may risk over-analysis, to fill the timeframes determined by the codes and the hard-wired processes, lack of resource can lead to [necessarily] complex and sometimes controversial change proposals simply being pushed out to participants with proponents being asked to make the running.

Smaller players, such as distributed energy providers and micro-generation interests, are less able to deal with the complexities and time requirements of current Code processes. Smaller players may also find difficulty in accessing the processes which allow them to contribute to the debates. In some cases, Working Groups have to consider relative costs/benefits when they lack the resources to properly quantify them.

- Ofgem needs to review how proposals for change can be independently, adequately resourced and assessed, such that all stakeholders are able to participate fully in the industry governance processes – and where possible processes are streamlined/simplified. There is merit in reviewing the initial proposal assessment and

development phase. Many potentially positive changes to industry rules suffer due to being [sometimes unavoidably] insufficiently developed before being subjected to the assessment process, which in many cases is adversarial in nature.

Critical analysis of modification proposals – minimum standards for quality and depth of analysis provided in the code modification report process. Experience in this area has been variable. Some modification reports and consultation documents are incomprehensible on a standalone basis and lack an effective and critical assessment of modification proposals. This can lead to industry participants suffering from incorrect or incomplete understanding of the impacts of proposals on their organisations, or even effective exclusion from the process. Without sufficient rigour and appropriate resources directed to the assessment/reporting process, Ofgem's ability to meet the high standards required of it is compromised, to the detriment of all stakeholders.

- Minimum quality standards are required for the consultation/reporting/assessment process. There needs to be consistency in the level and quality of information available and used by industry, code reviews and Ofgem. Sufficient resource to enable this to be executed in a timely manner needs to be provided.

Code Objectives – Fitness for Purpose

The industry is characterised by increasing complexity, continuing structural change and the evolution of the statutory framework. Code governance development has so far been largely on a "silo" basis which runs the risk of not appropriately recognising the impact of change on other frameworks, and risks omitting beneficial changes which can only be properly recognised after a "pan governance" assessment.

- The appropriateness of each individual Code "objective suite" and their relationship to each other urgently needs to be fundamentally reviewed. Individual change processes need to provide links for "pan-governance" optimisation.

Since the inception of the code objectives the wider statutory framework within which decisions on those codes made by the Authority has changed. As such, consideration needs to be given to supplementing the existing objectives in line with the new responsibilities generated by the changing statutory framework.

- Code objectives need to be enhanced to reflect additional responsibilities and duties which are now in place. Sustainable

development, climate change and renewable energy objectives need to be appropriately and clearly incorporated.

Charging Methodologies

Transmission and distribution charging methodologies are governed wholly by gas and electricity network owners and operators under their licences. In preparing these methodologies network owners have a suite of requirements and obligations placed upon them.

Charging methodologies and the resultant charges are a fundamental influence on the development of gas and electricity markets and on market participants. They also have a wider policy impact, to the extent that they can influence the both the viability and siting of renewable generators.

There is value in considering much earlier in the assessment process how the effect of proposed modifications might be incorporated into the charging methodologies themselves. This would assist in the overall consideration of proposals, without fettering the discretion of those parties who have effective "ownership" of charging methodologies. Under current arrangements, it is possible for proposed modifications to reach an advanced stage of development, prior to the potential charging implications being understood.

- A beneficial reform would be the establishment of a wider ranging forum for transmission issues. [The recent TASG illustrated the value of this approach]. This would allow the consideration and integration of [e.g.] BSC, CUSC and charging elements into the development of change proposals at a more suitable point in their development.

There is currently no suitable process to allow "optimisation" across code governance and as such proposals which may have a significant net benefit, but individual components which produce small dis-benefits under one governance regime cannot be properly assessed, or proceed in the absence of an appropriate and effective cross code amendment process

The governance of the charging methodologies is managed by the network operators themselves rather than through independent entities.

- The relevant charging methodologies should be transferred into the industry codes and governed by independent code administrators. Proposals for change should be accepted from a wider stakeholder community [subject to certain criteria]. Charging methodologies should not be used to either block legitimate change proposals in other Codes, or negate the objectives of changes when they have been made.

Structure and Process

The “fitness for purpose” of Code Panels and other committees, their representation and methods of working should be reviewed.

There is a wide diversity of Panel structures with differing representation based upon industry election, consumer representatives, appointed members and chairmanship. The BSC, CUSC, DCUSA, MRA, Grid Code and SO-TO Code all have different approaches to populating the governing boards and they all have widely divergent business procedures. Voting procedures range from a simple one party one vote, to others based on participant class voting or defined nomination rights.

Decision-making rules are similarly diverse. As an example, the BSC Panel makes decisions based on a straight majority, with the chair having a casting vote. However, under the DCUSA, in contrast, it is the votes of the participant classes that matter, and its business is differentiated between changes that can be implemented without reference to the Authority and those that must be. Another different approach applies under the UNC, and it is the votes of the industry members that are tallied and taken into account and form the basis of recommendations to Ofgem.

There is clearly scope for review, in order to reduce complexity, promote harmonisation and to ensure that representation and process are, and are seen to be, equitable.

It is for consideration what the appropriate panel composition, Electoral College, degree of independent input etc may be, in order to ensure a balanced representation of stakeholder interests.

However, core objectives should include:

- assessment processes that are clear and predictable.
- a common approach to development of alternatives to change proposals - *[where there can be more than one alternative but significantly fewer than the number the CUSC presently enables. All alternatives should be identified and consulted upon during the assessment or working group phase, not after reports have been written.]*

Other Issues



- The scope for reform to avoid duplicated or conflicting governance should be addressed.

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