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2008

22 January

Your Ref: Ofgem doc 284/07

Dear Mark

### **Review of industry code governance: open letter**

energywatch welcomes the opportunity to engage in the debate on industry code governance and the scope of any future review. This response is non-confidential and we are happy for you to publish it on the Ofgem website.

In providing our comments below, we believe that there is a distinction to be drawn between industry codes of a 'technical' nature, e.g. the Grid Code or Distribution Code, and those which are clearly commercial or hybrid (semi-commercial) in nature, e.g. the BSC and DCUSA. The former are essentially operating manuals which are unlikely to impose costs on consumers. Consumers do indirectly bear the costs of decisions made in relation to the latter and so have a substantive interest in how those codes operate and the governance around them.

We note, however, that Ofgem's decision last year on British Gas Trading's appeal regarding the use of the objections process under the MRA to retain non-domestic customers has muddied the waters as far as this code is concerned. The MRA would usually fall into the 'technical' category, as it is essentially a process rulebook for parties engaged in transferring customers when a change of supplier takes place. Ofgem's decision suggests that there is a potentially commercial slant to this code. Ofgem must be mindful that by indirectly impacting consumers in this way, the 'self-regulatory' nature of the MRA is under question.

### **General comments**

The industry codes are essentially more detailed rules for organising the commercial relationships between the various industry parties. Otherwise these would need to sit within the licences which all market participants require before they can take part in the energy markets, making the licences themselves complex and unwieldy. The requirement for industry codes is therefore not open to question. However, we do question whether the current codes are 'fit for purpose' in terms of the markets which they seek to administer and whether they are too complex in this regard.

Ofgem has recently completed a 'root and branch' review of the electricity and gas supply licences. Although the process took some time and involved a wide range of stakeholders, it was a useful attempt to analyse in detail whether the supply licences still fitted with the evolving nature of the energy supply markets since full liberalisation in 1998. We believe that Ofgem should at least consider whether such a fundamental exercise is required in relation to the industry codes. Any such exercise will also require wide stakeholder involvement but can run in parallel for each code so that a timely review can be delivered. We believe that consumers do not obtain value from the current processes in a number of areas and that a 'root and branch' review process may simplify and improve the rules for engagement.

Ofgem highlights a number of recent developments which have led it to consider the need for a review of industry code governance, fundamental or incremental. We agree that there are some substantive issues which now need to be addressed through a review of the administration and governance of the industry codes. Our main areas of concern, in part reflecting Ofgem's concerns, are as follows:

- the role of consumer representation;
- the relevance of current code objectives;
- the need for wider participant involvement compared to now; and
- fragmented governance.

### **The role of consumer representation**

As energywatch's closure approaches, we are particularly concerned about how consumers will be represented under the codes where these impose costs which consumers ultimately pay. The nature of consumer representation is currently quite uneven. For instance, under the BSC, there are two representatives appointed by energywatch to the BSC Panel. Under the UNC, there is no consumer representative on the Modifications Panel but a consumer representative may come and

speak at the Panel. Similarly, the right of consumer representatives to raise change proposals can be uneven across different codes.

Both the BSC and UNC address issues which are not confined to code parties but have wider commercial implications, with costs ultimately passing to consumers. If consumers are left with no voice, or if that voice is constrained in some way, consumers, who are not direct parties to any of the codes, may experience detriment and have no remedy. Ofgem has a primary statutory duty to protect consumer interests but this is also tempered by the need to facilitate competition which may not always lead to an optimal result.

We believe that how consumers' voices are heard is critical within code governance structures and Ofgem must certainly look at this question more carefully, whether in isolation or as part of any forthcoming wider review.

We also believe that the extent to which self-governance is established under the various codes needs further examination. Increased or full self-governance directly affects code signatories and would allow them to take a more representative approach on code Panels. Is this necessarily a good thing when, even currently, party size can determine influence in decision-making? It does not matter that ultimate decisions may be made by Ofgem; a representative Panel would by necessity exclude some voices from decision-making. We feel more comfortable with an independent Panel model but we believe that the review should consider in more detail whether there are improvements to be made on the current processes.

### **The relevance of code objectives**

The current code objectives in some cases remain sound but try to do too much. From our experience on the BSC Panel, we have found that trying to address the impact on consumers of a modification is constrained by the current wording of applicable BSC objectives. Does consumer interest necessarily sit alongside the promotion of competition in generation and supply every time? How do code Panels and workgroups assess a change proposal's compatibility with a sustainability objective that is increasingly an important part of British energy policy?

We agree that it is time to review the current code objectives to ensure that they reflect recent changes in legislation which has created new objectives and duties, not least on Ofgem, which are more suited to changing energy market priorities. Ofgem has asked for improvements in the quality of analysis provided to it so that it can make more robust decisions but this is surely incompatible with code objectives which constrain the debate at both workgroup and code Panel level? If the

result of a code assessment process is merely to provide half the answer, leading Ofgem to undertake a further impact assessment, this is merely adding to administrative inefficiency.

### **Wider participant involvement**

We agree with Ofgem that the need for wider stakeholder involvement in code processes should be assessed in a governance review. The great limiting factor for many potential participants is how much resource to expend in engaging with codes which can have a significant impact on them. The lack of involvement may be a result of the complex nature of codes which make them inaccessible and difficult to engage with.

We also believe that those who are impacted by the changes made to codes need to be involved both in the decision-making process but also in the ability to raise change proposals. Although we accept that network operators are the key players in deciding how to develop, and charge for, networks to meet their licence objectives, they are not the only affected parties. In fact, the users of actively managed networks may have an increasing role to play in how those networks develop in an efficient and economic manner. To prevent them from raising change proposals on charging methodologies is unnecessarily limiting and can have significant impact on the costs passed through to passive users, namely, the vast majority of consumers.

### **Fragmented governance**

We note that Ofgem has raised this issue as one which could be explored by a review. We agree fully with this. Cross-governance issues are not currently addressed effectively or efficiently. However, this is, to some extent, symptomatic of the way that governance arrangements were developed in the run-up to NETA go-live. It is the compartmentalisation of cross-code issues which hinders proper consideration of them. Code workgroups and Panels are told from the outset that they must consider changes only within the context of the applicable code objectives, regardless of the cross-code effects. An alternative that perhaps allows cross-code workgroups and Panels to consider certain changes should be explored. While this may also impact on who delivers code administration and how, the purpose of code administration is to deliver efficient and effective processes, not to create complexity for the sake of it.

### **Other issues**

We note and agree with Ofgem that many of the issues raised in this section of the Ofgem letter are worthy of further consideration. We also

note the substantial emphasis placed by Ofgem on the need for quality assessment and robust outcomes at the code governance level before reports are delivered to Ofgem. We believe that Ofgem must recognise that some of the issues we have highlighted above provide some rationale for the current shortcomings in industry code governance. Quality is only deliverable if the processes allow it.

The watchwords for effective and efficient code governance must be ***simplicity, accessibility, inclusiveness and flexibility***. We believe that Ofgem should pursue a review of the current governance model, and consider any changes to it, with these characteristics in mind. Consumers expect the industry to organise its processes in a way that limits the indirect costs that are passed on to them. If the industry is unable to deliver, Ofgem must take a leading role instead.

We will continue to keep these issues under review and engage further with Ofgem through events and consultations as necessary, always considering the possible impact on consumers.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley  
Head of Regulatory Affairs