

Industry governance—time for a spring clean?

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Several years ago a senior industry manager commented to me that I was the only person he knew who was genuinely interested in industry governance. I'm not sure it was meant as a compliment, the implication being we were spending too much time discussing how to do business rather than getting on with actually doing it. A legitimate point perhaps, but one that ignored the fact that rules of engagement at the time inhibited sensible change from happening.

On the whole I have been very supportive of the profound changes to the way the energy industry sets and administers its rules, especially the shake-up that occurred in 2001 with the introduction of Neta. But of late a number of issues—reported in this publication over recent weeks—have highlighted issues about rule and code development, and this reminds me that it's timely to make some broader remarks about the state of industry governance, which is the theme for this *Energy perspective*. The main argument is better does not mean it cannot be bettered.

Antidote to Pool impasse

The importance of new-style governance at least in the electricity sector was well set out by David Currie, one of the architects of the new Neta arrangements and adviser to Ofgem. He commented in a 2000 Beesley lecture: "The major virtues of [the new trading arrangements] are twofold: [it] moves the electricity market much closer to that of a normal market; and that it puts in place a governance structure that allows for relatively easy adjustment and change. In both respects, it represents a major advance on the Pool." In other words "they put in place a better structure of governance that will allow the arrangements to evolve organically in the light of experience." Remembering back, Currie responding to a question, added that Neta was half a solution, with the new governance arrangements making it whole.

In fact the importance of governance was highlighted throughout the Neta development stream, with emphasis being placed on the merits of the approach adopted from the mid-1990s in the gas market. This approach centred on development of a code created under statutory licence that embedded high-level principles and requirements on a panel with varied membership to act objectively in assessing change proposals efficiently and effectively. The following is a quote from the milestone 1999 Ofgem blueprint for Neta explaining why this was the preferred approach: "Decision-making under the existing Pool governance arrangements has been inherently factional in nature, with diametrically opposed interests often leading to impasse and delaying beneficial change. A different approach is now desirable, with emphasis more on objective decision-making with reference to predefined objectives than on negotiation amongst competing commercial interests." It is hard to disagree with these sentiments.

Very similar quotes can also be found in the design documents for both the Connection and Use of System Code (Cusc) and more recently for the Distribution Connection and Use of System Agreement (Dcusa), and there is a

strong implication from the literature that we now have common governance across energy industry codes and largely uniform processes.

Similar is not the same

The reality is somewhat different. From the outset there remained significant differences in the operation of code governance, as the following examples illustrate.

The Balancing and Settlement Code (BSC) took the same legal structure as the then Network Code for the gas industry, but embedded a different panel structure. Whereas the network code (and its successor body the UNC) is essentially comprised of industry representatives, the BSC adopted a hybrid structure with five industry elected members, two consumer representatives and two appointed independents under an independent chair. Cusc implemented at the same time as the BSC had seven (not ten as I recently misreported) industry elected members and a fall back pool of elected alternates. The chair, although constituted as an independent position, is in the gift of National Grid. The Dcusa was formally constituted last year again within the same overarching principles, but panel members are voted representatives of industry constituencies (though in reality this approach was adopted by Ofgem for Dcusa as the only realistic way to get a governance structure in place that drew sufficient support from the industry to enable a collective licence change to be made).

And to complete the kaleidoscope, the Master Registration Agreement, the Grid Code, the Supply Point Administration Agreement and the SO-TO Code all have different approaches to populating the governing boards, but with a shared feature that differs from the other panels that they nominate their own chair, and they all have widely divergent business procedures.

Electoral practice differs too, with each arrangement having their separate arrangements (no two are the same) varying from in some cases rather exotic and (over?) complex systems under the BSC and Cusc, to others being based on a simple one party one vote, and to others based on participant class voting or defined nomination rights.

Decision-making rules are similarly diverse. The BSC Panel makes decisions based on a straight majority, with the chair having a casting vote. Initially the Cusc panel did not systematically vote on change proposals (though it does now), but the chair's casting vote has been removed. But under 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 are evidently many ways to skin the proverbial cat. And as long as the processes work within their own terms of reference and matters are brought forward to the Authority after due process, surely these matters should be left as they are and be allowed to evolve organically?

A case for review

With a minimum of nearly six years of experience under the belt of the main codes, I believe it is timely to take stock of how these arrangements work. It needs to be borne in mind that the governance arrangements have been far from static over that period. Several procedural enhancements have been made across virtually all the codes, especially in the ones on which this opinion piece is most closely focussed (BSC, Cusc and to a lesser extent



Dcusa, and to a lesser extent still the UNC). In the case of the BSC some major changes have been brought forward and kicked back, most notably a change proposal from E.ON UK to recast the panel based on industry constituencies.

But it is evident that change is needed in at least two very different

respects.

The first is relatively easy—it concerns the different norms and processes adopted by the various governance structures. A glance at the different reports that come forward from these bodies shows that there are big differences in form and style. There are also different conventions on when to consult and on what. Recently I missed a couple of Cusc reports because of my own confusion about their status and whether there would be another opportunity to feed in views. Unlike under the BSC the industry consultation occurs after the working group has reported. In gas consultation occurs on the proposal itself and the report is in many ways a synthesis of views put forward against some defined headings with very little analysis. I should probably have known better but many participants who we deal with, especially those with very limited resources, struggle to cope with the volume of virtual modification business that passes the computer screen each day, and little is done to help them assimilate and prioritise information quickly.

Even little things hinder—some code secretariats don't label the subject matter of the change they are progressing, giving simply numbers and expecting recognition, or the status of the circulation and sometimes not even a close date where a response is sought. Direct links to original documents are sometimes provided, other times not, and sometimes these don't work anyway or the documents have not been posted. Overall there is a presumption that everyone is highly literate in all aspects of code business and process, which frankly is not the case.

More importantly there are big differences in the substance and quality of consultations and reports. This variable arises at least in part as a result of the different types of underlying process stipulated in the codes, but they also have widely varying levels of comprehensibility. It is commonplace for reports to be in excess of 30 pages for even the simplest of change proposals and sometimes in excess of 100 pages in electricity though some recent gas reports on fundamental changes have been sparse. Added to this

documents can be poorly structured and don't enable the reader to work through them efficiently by focussing on the key issues.

Some recent modification proposals and reports under the UNC are not self-contained in that they require attendance at meetings to understand what is proposed and how proposals differ from other change proposals that are live. Some of the lack of clarity flows from the time constraints the process is working up against imposed by Ofgem, and also because of constraints on resource. But at least some of the problem arises because the initial proposal is not written in clear, plain English. Perhaps we need a common template of information that should be included in covering emails, as well as for the change proposals themselves and the resultant reports.

Another factor also is that some governance processes are endowed with more resource than others. Abundant resource may be a mixed blessing as some issues can be over-analysed to fill the timeframes determined by the codes and the hard-wired processes. In contrast other complex and sometimes controversial change proposals can be simply pushed out to participants with proponents being asked to make the running.

In conclusion if Europe (in the main) can adopt the Euro, surely the energy industry as a whole with so many players active in both electricity and gas can adopt a single, best practice process for developing modification reports that attempts to provide comparable levels of assessment against broadly similar criteria? I am not saying the industry needs a common language like Volapuk or Esperanto, but some sensible cross-fertilisation of good practice would go a long way.

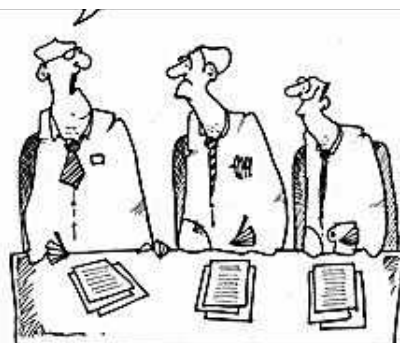
The second area is less straight-forward but arguably more important. The one, single most important change in sectoral governance since the Utilities Act in 2000 (and the conflation of Offer and Ofgas into Ofgem it introduced) has been the introduction of the ability to appeal Ofgem decisions on designated codes to the Competition Commission. This option is available only where the regulator takes a different view to the sponsoring panel.

But this condition imposes a common standard against an asymmetrical baseline, which as a minimum suggests to me the need for some common process if referral is to occur. Above all it implies a similar series of checks and balances should be applied, and that consistency is required in panel composition and the governance of those panels in terms of their top-level functionality and how they conduct business. This is not just about making the commission's life more easy; it is about ensuring some basic consistency in the quality of the process, that is constructed on the same principles but which has become too diverse and fragmented.

Some thoughts on changes

Personally I have a preference for BSC-style arrangements in terms of panel composition. In a context in which the industry—especially the scale players—will always has the upper hand because of the resources it has, some form of hybrid panel is

***I vote for chocolate biscuits,
sudoko in the toilets and an
end to all Pret sandwiches***



essential. The independent nominees on the BSC bring a different dimension and provide an essential counterfoil if industry-elected members get too technical or too parochial. The presence of consumer representatives regularly provides a ready sense-check, which is essential given the primary statutory duty of the regulator, and it is hoped that all the panels that preside over commercial rule books will continue to have routine consumer participation after the demise of energywatch. An independent chair is to my mind also an essential feature of an independent governance structure.

I also like BSC practice in terms of the clarity and predictability of its assessment processes (with the possible exception of the definition procedure), though there should be a facility to short-circuit processes where more routine change is involved and much less paper across the board. There is no reason why a common standard process cannot be found for BSC, Cusc, UNC and Dcusa based on it. This process should also embrace 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. And all alternatives should be identified and consulted upon during the assessment or working group phase, not after reports have been written.

Finally electoral processes for industry experts can be simplified across the board on a one party-one vote basis, and it may even be desirable to allow for voting schools on this basis with participating in whichever school they wish to stand and/or vote in. The balance of membership should allow the industry to hold most seats because the panels are dependent on industry expertise, but there should be full transparency of any formal votes not just at panel but at the various working groups where industry parties make recommendations.

All in all there is much more that can be done to deliver the dual objectives of effectiveness and efficiency, which were the drivers for changes, in governance but which seem in some important respects to have been lost sight of.