

**Code Governance Review – role of code administrators and small participant/consumer initiatives****Document type:** Consultation

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**Date of publication:** 19 December 2008**Deadline for response:** 27 February 2009**Target audience:** Gas and electricity industry participants, consumer representatives, code administrators and other interested parties.**Overview:**

The industry codes provide a contractual framework containing most of the technical and commercial rules by which the gas and electricity industries operate. Recognising that those markets have matured and the nature of participation has evolved, the Code Governance Review ("the Review") aims to ensure that the codes are able to respond to the significant challenges currently facing the gas and electricity industries.

In June 2008 we released our decision on the scope of the Review and indicated that we would bring forward proposals relating to six work-strands, including the 'role of code administrators' and 'small participant and consumer initiatives'. In this document we consider ways in which the performance of code panels and administrators might be improved in respect of governance structures, quality of analysis and quality of service. We also consider whether there would be merit in harmonising the governance structures through a code of best practice. We also address the issue of whether code administrators should be required explicitly to consider the needs of consumers, small participants and new entrants and whether some form of financial assistance should be made available to smaller industry players to facilitate their involvement with the governance of the various codes.

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The Authority is committed to policies and processes that are consistent with better regulation principles and that reduce the administrative burden on business while maintaining effective consumer protection.

As part of that commitment, in November 2007 we announced the Review of Industry Code Governance. The industry codes provide a contractual framework containing most of the technical and commercial rules by which the gas and electricity industries operate. We considered that such a review was timely given the changes that are occurring in those industries, where the nature of market participation is changing, particularly with respect to new entrants and smaller players. The Authority's role in relation to code modifications has also changed with the introduction of additional statutory duties and the right of appeal to the Competition Commission.

In June 2008, we set out the scope of the Review and confirmed that a good governance regime should –

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

The Review is considering what changes are required to deliver these objectives. The review comprises several work-strands and a table setting out progress under each of these appears below.

<b>Work-strand</b>	<b>Update</b>
Major Policy Reviews and Self Governance	Ofgem consultation issued today – Responses due 27 February 2009.
Charging methodologies	Ofgem consultation issued September 2008 – Responses due 16 January 2009
Code objectives and the environment	Ofgem consultation issued November 2008 – Responses due 16 January 2009
Complexity and fragmentation – Code Administrators Working Group	Five meetings have occurred to date. Due to issue draft report February 2009. Further details can be found on Ofgem's website at <a href="http://www.ofgem.gov.uk">www.ofgem.gov.uk</a>
Role of Code Administrators and small participant/consumer initiatives	Ofgem consultation issued today – responses due 27 February 2009

This document sets out our proposals on **the role of code administrators and small participant/consumer initiatives**. The issues that it covers overlap to some

extent with those covered in the first work-strand (major policy reform and code objectives) and the Code Administrators Working Group, which has been convened by Ofgem.

- Open letter announcing review of industry code governance - 284/07, November 2007:

[www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/Open%20letter%20announcing%20governance%20review.pdf](http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/Open%20letter%20announcing%20governance%20review.pdf)

- Corporate Strategy and Plan 2008-2013 - 34/08:

[www.ofgem.gov.uk/About%20us/CorpPlan/Documents1/CORPORATE%20STRATEGY%20AND%20PLAN%2028%20MARCH%202008.pdf](http://www.ofgem.gov.uk/About%20us/CorpPlan/Documents1/CORPORATE%20STRATEGY%20AND%20PLAN%2028%20MARCH%202008.pdf)

- Review of industry code governance - scope of review: 92/08, June 2008:

[www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/GovRevScope%20-%20MF%20Final%2030%20JUNE%202008.pdf](http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/GovRevScope%20-%20MF%20Final%2030%20JUNE%202008.pdf)

- Code Governance Review: Charging methodology governance options, Ofgem, Ref: 132/08

[www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/CGR\\_CM\\_Sept\\_FINAL.pdf](http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/CGR_CM_Sept_FINAL.pdf)

- Review of Industry Code Governance – Environment and Code Objectives, Ofgem Open Letter, 21 November 2008

[www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/open%20letter%2020%200%20November%20draft%20\\_4\\_.pdf](http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/open%20letter%2020%200%20November%20draft%20_4_.pdf)

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## Summary

This document sets out options regarding the role of code administrators as well as a number of initiatives intended to facilitate the engagement of smaller participants, consumers and new entrants in the industry code arrangements and code modification processes. The consultation forms part of Ofgem's ongoing review of industry code governance arrangements, whose scope was determined in the Gas and Electricity Market Authority's June 2008 decision letter ('the June document').

Over recent years the code arrangements have worked well to deliver reform and change. However recently we have become concerned that the code arrangements have become complex and difficult for new entrants, small participants and consumers to engage in. This is particularly the case as the nature of participation in the gas and electricity sectors is changing fundamentally, with the entry of smaller renewable and distributed generators, along with smaller suppliers. These participants are often less well resourced than the large incumbent energy market participants and find it difficult to engage in the codes arrangements, including the code modification process.

In addition, the code arrangements are highly fragmented, with 7 codes underpinning the market arrangements in the electricity sector alone. Market participants therefore need to understand and devote significant resources to each code process to engage in and influence policy outcomes. This can be particularly difficult for new entrants, consumer representatives and small participants.

With the changing market landscape and the increasing emphasis on the environment and climate change, the nature of market participation is likely to continue to evolve with smaller participants entering the market. It is therefore important that the code arrangements remain robust for the future.

This document sets out a number of proposals and options that could deliver a set of code arrangements that are more accessible, efficient, and transparent, particularly from the perspective of new entrants, small participant and consumer representatives. The options set out in this document also look to improve the accountability of code administrators in terms of their quality of service and their costs. Ofgem has recently identified concerns regarding the quality of code modification reports and we consider that mechanisms may need to be introduced to improve code administrator performance and accountability in this area. Given the evolving nature of the market it is particularly important that all market participants are provided with comprehensive modification assessments that are supported by robust analysis that is reported in a clear and transparent manner.

The potential reforms set out in this document therefore form part of Ofgem's **better regulation** work in terms of improving the efficiency, transparency and inclusiveness of the code governance arrangements. This consultation considers changes that could be made in respect of:

- the role and responsibilities of code administrators in relation to code modifications;
- the separation of code administration responsibilities from the management of the systems that are underpinned by the codes;
- the governance of code administrators;
- the funding of code administrators;
- evaluating the performance of code administrators; and
- the involvement of small participants, consumer representatives and new entrants in the codes.

Ofgem has also today published a consultation document on amending the code modification governance arrangements to allow for Ofgem-led Major Policy Reviews and for industry self-governance arrangements in respect of modifications that are unlikely to have material impacts on consumers or on competition.

### **Initial assessment of options**

Our initial assessment is that there is scope for improvement in the way that code modifications are handled and assessed. There is also scope for improvement in the organisation and efficiency of the code administrators and panels. This should help to ensure that consumers obtain the benefits associated with code improvements in a timely manner. In addition, if the analysis underlying Panel recommendations on modifications is of a higher standard, it should enable Ofgem to focus its resources on those issues that are likely to have the most material impact on consumers and competition. As noted above, improved quality of analysis and more transparent code assessment processes and reporting should also help market participants, particularly small participants, new entrants and consumer representatives to engage in the code modification process.

We also consider that there are a number of specific ways in which small participants, new entrants and consumer representatives could be helped to engage more effectively with the code governance procedures, for example through the creation of advocacy panels, obligations on code administrators to assist these parties, or automatic rights to code panel membership (with voting rights).

## 1. Introduction

### Background

1.1. In November 2007 we initiated a review of the industry codes governance arrangements with an open consultation. The review was triggered by a number of factors, including:

- the major industry codes were introduced some time ago, since when there have been significant changes in the market and regulatory landscape which raise the possibility that the governance arrangements may no longer be optimal:
  - the Authority's statutory duties have changed, for example with the inclusion of duties relating to sustainability, the environment, and better regulation;
  - certain decisions of the Authority in relation to code modifications are now subject to appeal to the Competition Commission;
  - the Authority is now required to undertake Impact Assessments before reaching certain important decisions, including in relation to some code modifications;
  - the nature of the market place continues to evolve, in particular with the entry of smaller players including renewable and distributed generators;
- concerns have been expressed that the existing code arrangements are too complex and inaccessible, particularly for the smaller new entrants in the market, and more generally that there may be weaknesses in the way the codes are governed which prevent industry and consumers from getting full value from the code arrangements.

1.2. In addition to responses to the open letter consultation in November 2007, we also heard perspectives from a number of industry speakers and participants at a Powering the Energy Debate (PED) event in February 2008. Finally, we also commissioned an independent critique on the codes governance arrangements. This was undertaken by the Brattle Group (Brattle) and the law firm Simmons and Simmons.

1.3. We were also concerned that the codes arrangements have hindered progress in key areas of policy development. Cash-out and transmission access reform are two such areas.



## Purpose of this document

1.4. In the June document we stated that we would issue a consultation on measures to improve the performance of code panels and administrators on the quality of the analysis they provide, including ways in which the Authority could engage further with the industry consultation process.

1.5. We also explained that we would consult on:

- *Improvements that can be made to the governance structures of the code administrators and panels. We consider that there is merit in exploring the introduction of independent company and board structures for the administration of the major commercial codes such as the UNC and CUSC which do not currently have them and in reviewing the governance structures of the other major commercial code, the BSC. We consider that this may improve the accountability of administrators in terms of costs and quality of services and more generally, in the delivery of the code objectives...;*
- *Whether Ofgem should undertake benchmarking of the code administrators to compare their costs and service delivery, with a view to making them more accountable;*
- *Whether there is merit in introducing independent panel chairs for those codes that do not currently have them; and*
- *Whether consumer representation rights on code panels should be aligned across all codes, such that designated consumer representatives have the rights to vote on proposals and raise modification proposals under all codes.*

1.6. Finally, we stated that we would explore further and consult on initiatives relating to small participants and new entrants, specifically:

- *Whether there are requirements that should be placed upon code administrators or code panels to consider the needs of smaller participants and new entrants in the administration of the codes modification process*
- *Whether a central industry based fund or some other form of assistance should be established to assist smaller participants in engaging in the codes modification process. This could enable smaller parties to draw upon resources that would help them participate in code change working groups or indeed, assistance in the development of modification proposals.*

1.7. The purpose of this document is to go through each of these issues, provide possible options for change and consider their advantages and disadvantages both as between themselves and compared to the status quo.

**1.8. We would welcome written responses on this document by Friday 27 February 2009.** Further details on how to respond to the consultation are set out in Appendix 1.

**1.9. In order to help inform written responses to this document we intend to hold a work-shop on our proposals. This will be held in early February and details of the work-shop will follow shortly. Respondents interested in attending a work-shop on the issues raised in this document should contact Jenny Boothe on 0207 901 7122 or [jenny.boothe@ofgem.gov.uk](mailto:jenny.boothe@ofgem.gov.uk) by 16 January 2009.**

### **Related work – Code Administrators Working Group**

1.10. As part of the Review, the Ofgem chaired Code Administrators Working Group (CAWG) was convened. The objectives of this group are to explore, identify and progress opportunities for:

- making the code modification process more accessible, usable and transparent for all parties including consumer representatives, new entrants and smaller market participants; and
- encouraging best practice and, where appropriate, the simplification and convergence of code modification processes.

**1.11. The group comprises members from the code administrators (Elexon, Joint Office, and National Grid (NG)) as well as industry participants from all sectors of the gas and electricity industries, including EdF Energy, Good Energy, RWE, Centrica, E.ON, MEUC, Association of Electricity Producers and Cornwall Energy. Representatives from Consumer Focus and the Better Regulation Executive also attend. The group has now met on five occasions and intends to prepare a draft report setting out its conclusions in February 2009.** The group has made good progress in identifying improvements to the code modification processes. Many of the policy proposals set out within this document have been discussed with the group and the group may wish to comment on the matters raised in this document in preparing its report. Indeed, some of the proposals contained in this document, including the Code of Practice for code administrators, were generated from Working Group meetings.

### **Structure of document**

1.12. The remainder of this document is structured as follows:

- chapter 2 sets out the key issues being addressed by our proposals, and the Authority's objectives for the reforms;
- chapter 3 deals with the roles and responsibilities of code administrators both with regard to code administration and key systems management;
- chapter 4 focuses on the governance of and funding arrangements for code administrators;
- chapter 5 considers other issues relating to code administrators;
- chapter 6 contains a series of possible options for facilitating the involvement of small participants, consumer representatives and new entrants; and

1.13. Further background on the governance arrangements for the gas and electricity codes is set out in Appendix 2.

1.14. An initial assessment of the impact that the options discussed in this document is set out in Appendix 3.

## 2. Key issues and objectives

### Chapter Summary

This chapter outlines the three main problems with the current code administration arrangements that the Authority has identified. These are deficiencies in the quality of analysis, a lack of accountability and/or transparency in the governance arrangements of some administrators, and concerns that the current governance structures disadvantage small participants, consumer representatives and new entrants. It describes the objectives against which Ofgem considers that potential changes in all three areas should be measured.

### Question box

**Question 1:** Are the Authority's concerns regarding the quality of analysis undertaken through the code modification processes justified?

**Question 2:** Are some code administrators more accountable than others?

**Question 3:** We consider that code complexity is a problem, particularly for small participants, new entrants and consumer representatives. Do you agree? How can the complexity be reduced?

**Question 4:** Do small participants, new entrants and consumer representatives find it difficult to engage with the code modification process?

### Problems this consultation addresses

2.1. In its June document the Authority highlighted several problems with current code governance arrangements that relate to the role of code administrators and the position of small participants. These problems were identified on the basis of experience with the current codes framework.

#### *Quality of analysis*

2.2. The quality of analysis undertaken for modifications is often inadequate and this can require Ofgem to carry out extensive additional analysis. Deficiencies in the quality of analysis on modifications increases the burden on the Authority in terms of the work necessary to carry out an assessment of the merits of modifications and to reach decisions in a timely fashion. In addition, code modification reports prepared by code administrators and panels are often complex and opaque, which potentially creates barriers to participation and engagement for small market participants, new entrants and consumer representatives.

### ***Accountability of code administrators and Panels***

2.3. There are significant differences in the way that the various code panels are constituted and how they and their code administrators operate. The result is that some code administrators are more accountable to the code signatories and other interested parties than others, in terms of costs and quality of service. In addition, the variety of governance structures for code Panels and modification regimes increases the complexity and opacity of the modification processes and this can also have adverse implications for accountability.

### ***Engagement of small participants, consumer representatives and new entrants***

2.4. The complexity of the current arrangements has led to the Authority having concerns regarding the ability of smaller participants, consumer representatives, and new entrants to engage with the code arrangements. We have already noted above the difficulties faced by small market participants, new entrants and consumer representatives in accessing and understanding complex modification reports. These parties also face difficulties in engaging in the code modification process itself. For example, small market participants regularly face difficulties in progressing modification proposals through modification work-groups which can become dominated by larger incumbent energy companies who have the resources and a better ability to influence outcomes. Similarly developers whose projects may be affected commercially by code changes may be unaware of relevant change proposals proceeding through the code governance processes.

2.5. Further, in terms of consumer participation, whilst Consumer Focus is represented on some of the code panels, there is little direct consumer engagement at working group level and relatively few consumer sponsored modification proposals have been raised. To some extent, Ofgem representatives can reflect consumer views but this cannot be as effective as direct consumer representative participation.

## **The industry codes governance review objectives**

2.6. The various options set out in the remainder of the document are designed to address the key problems identified above. As with all the work undertaken for the governance review, our fundamental objective is to develop an overall set of code governance arrangements that leads to more effective and efficient decision-making in line with the criteria set out in the November 2007 letter:

- 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.

## 3. Roles and responsibilities of Code Administrators

### Chapter Summary

This chapter considers the current roles and responsibilities of code administrators both with regard to code modifications and systems administration. It discusses two possible ways in which the role of code administrators could be developed so as to enhance the quality of the analysis that is carried out. It also discusses whether there are advantages in giving code administrators responsibilities for systems management and seeks views on whether such advantages are sufficient to justify imposing this responsibility on all administrators.

### Question box

**Question 1:** Do you agree that the quality of analysis in code modification reports could be improved? Should the role of the code administrator be changed to help enhance the quality of code modification reports?

**Question 2:** Which of the options for changing the role of the code administrator in the modification process (critical friend or active secretariat) is most appropriate? Should different options be chosen for different codes?

**Question 3:** Should the roles of the administrators of the BSC, UNC, CUSC, Grid Code, SPAA and MRA in respect of central systems management be harmonised i.e. should all code administrators either be made responsible for the related systems or should this responsibility be removed from them all?

### Context

3.1. In this chapter, we consider the roles and responsibilities of code administrators both in relation to code modifications and systems.

3.2. All the code administrators have a secretariat role for code modifications: they coordinate and chair modification meetings, compile modification reports and publish modification related documentation on their websites. However, some code administrators, notably Elexon and NGET (as the CUSC and Grid Code administrator), have a wider role. They are responsible for more of the assessment process, particularly with regard to the systems implications of proposed modifications. This enhanced role in modifications follows from the fact that these code administrators are responsible for managing the key systems associated with the codes. Further details of the roles of the various code administrators can be found in Appendix 2.

3.3. Whilst some code administrators, such as Elexon, provide assessments of the impact of code modifications on the central systems, generally most administrators do not provide additional market assessments to those that are carried out by

modification working groups (or work-streams) and panels. Their role is largely to report the analysis carried out by modification groups and the views expressed by respondents to modification consultations.

3.4. Consequently, it is the code panels that primarily determine the type of assessments that are carried out, through the terms of reference that they provide to the relevant modification group. We note, however, that for some codes e.g. DCUSA, the code administrator provides the first draft. It is then the responsibility of the modification group to carry out the required assessment. As we have highlighted throughout this governance review, we are concerned that the quality of assessment provided for modifications is often inadequate. This can either be because important potential impacts have not been analysed or because the analysis that has been carried out is flawed in some way e.g. with respect to the assumptions made or the data used. We consider that these quality problems might be reduced if the code administrators were to play a more active role in the modification process.

3.5. There are, of course, important interactions between the responsibility of the code administrators for modifications and the proposals that we have put forward in respect of Major Policy Reviews and self governance. If implemented, the Major Policy Review proposals would be likely to result in Ofgem taking the lead on the most difficult and far-reaching issues, reducing the need for analysis that would otherwise be undertaken by modification groups.

3.6. On the other hand, there would still be a need for robust analysis for modifications that follow the normal (status quo based) modification route in which the panel sends the modification to Ofgem for decision. Similarly, adequate analysis will also be required under the self-governance proposals because there would no longer be the possibility for Ofgem to fill in any gaps in the analysis (other than if a modification decision is appealed).

## Options for change

3.7. In considering how the role of code administrators in the modification process might be changed to improve the quality of analysis provided, we have assumed that primary responsibility for the assessment of modifications should remain with the code signatories via the panel.

3.8. Ofgem has developed two high level options for change: the “**critical friend**” and “**active secretariat**” approaches. It is important to bear in mind that the costs and benefits of these options will need to be assessed against the status quo.

### *Critical friend approach*

3.9. Under the critical friend option, the code administrators’ role would be expanded to include challenging the terms of reference put forward by the Panel, the analysis carried out by the modification group, the reasoning put forward by consultation respondents, and the conclusions drawn by panel members in reaching their



recommendation. In other words, the code administrator would act as a “devil’s advocate”, testing the appropriateness of the analysis that is being contemplated and the strength of the conclusions that can be drawn.

#### *Active secretariat approach*

3.10. The active secretariat option takes the critical friend idea a significant step further by giving the code administrator a much greater role in assessing code modifications. For example, the code administrator would have primary responsibility for the quality of the assessment that is performed. This would involve taking a leading role in drawing up the terms of reference for the assessment, collaborating with the modification group to ensure that the terms of reference are fulfilled, including (where necessary) commissioning external assessments (for example, to assess competition or environmental impacts), and in analysing and responding to consultation responses.

#### *Ofgem’s role*

3.11. As we indicated in our June document, it is also important to note that Ofgem currently provides assistance to code panels in defining the analysis that needs to be undertaken. Whilst Ofgem will try and provide assistance of this nature, it is important to recognise that there may not always be sufficient resources available given the substantial number of modification proposals raised across the codes each year.<sup>1</sup> In addition, it is often the case that Ofgem may not identify deficiencies in analysis until the modification has been formally submitted to it for decision and it has reviewed the proposal in detail.

#### *Other approaches*

3.12. There are also other more light-handed options which might enhance the quality of analysis in modification reports. These include the “call in” and “send back” procedures which are discussed further in Chapter 5. They should act as an incentive on code panels to ensure that robust analysis was undertaken.

3.13. Ofgem’s preliminary view is that these enhancements may not of themselves ensure ensure that high quality analysis is produced, though they would provide incremental benefits (as against the status quo) by encouraging the code panels to carry out their existing responsibilities more effectively. In addition “call-in” and “send-back” interventions should generally be regarded only as backstops where

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<sup>1</sup> We acknowledge that if self-governance was introduced for some modifications, this burden would reduce but it still remains the case that resource constraints may limit the assistance that Ofgem is able to provide at the analysis definition stage.

analysis is not being undertaken or where a modification report has been submitted to Ofgem with insufficient analysis.

3.14. Ofgem's preliminary view is that both the "critical friend" and "active secretariat" options would represent an improvement on the status quo but we do not have a strong view as to which approach is preferable. It is however important to recognise that both approaches might have staffing implications for at least some of the code administrators and these, and the associated funding implications, would be more significant under the active secretariat approach. For example, the administrator would probably need to employ staff with policy and economic expertise or have the resources to commission independent economic analysis. On the other hand, having dedicated teams available to carry out modification assessments should lead to higher quality analysis compared to relying on modification groups whose composition is inevitably dependent on the availability of relevant experts at the time when a modification is raised.

**3.15. We would welcome views on the "critical friend" and "active secretariat" approaches.**

3.16. It is important to emphasise that under both options, the intention is that the code administrators would still be acting in a supporting role to the code panel. Consequently, should either option be progressed it would be necessary to consider what safeguards might be required to ensure that the code administrators are not unduly influenced by any group of code signatories.

### Systems role

3.17. A further issue regarding the role of code administrators relates to whether or not they should be responsible for running the key systems associated with their codes e.g. the settlement and other communications systems. At present, there is a fairly even split between the code administrators who have responsibility for systems and those who do not.

- **Administrators with responsibility for systems:** Elexon (BSC), National Grid (NG) (CUSC and Grid Code) and Gemserv (MRA)
- **Administrators without responsibility for systems:** Joint Office (UNC)
- **Codes with no central systems:** Distribution Code (ENA), DCUSA (Electralink), iGT UNC (Gemserv), SPAA (Electralink) and STC (NG)

3.18. Experience to date suggests that there are advantages and disadvantages to both approaches, mostly related to the interaction between systems costs and code modifications.

3.19. There have been occasions when it has proved difficult to determine the likely systems costs associated with proposed modifications when the code administrator is not also the systems manager.<sup>2</sup> This is most clearly demonstrated under the gas UNC where the gas transporters often have access to costs and other information provided by their service provider xoserve, which is not freely available to other parties. This may not traditionally have been a problem, as it has been the GTs who funded change, as allowed for in their respective price controls. However, it does make it very difficult for other parties to properly assess the relative costs and benefits of proposals. This has been particularly problematic where there has been more than one potential way to address a given issue.

3.20. As such, there may be information and transparency benefits associated with having the code administrator also responsible for systems, as the administrator would be better able to assess the systems implications of modification proposals and make this information available to all stakeholders.

3.21. Conversely, there is clearly a potential conflict of interest when the code administrator also has responsibility for the systems. For example, it would be possible for them to over-estimate the cost implications of potential changes when they are not in favour of the modification. It is also possible that the systems operator may have an undue influence on the eventual proposal, either to minimise costs or disruption, or simply to conform to their own views. There might be fewer incentives for this to occur under a model where the systems are managed by a separate entity to the code administrator, as the code administrator would have no commercial interest in the systems related outcomes.

3.22. We note there have been occasions under UNC where industry participants have raised concerns with Ofgem regarding the adequacy of the cost analysis provided on code modifications by xoserve. We also note that UNC modification proposal 213, which has been raised by EdF, may if implemented go some way to address these information concerns. This modification seeks, amongst other things, to ensure that a robust assessment of costs is provided by xoserve at the request of the UNC Panel. Whilst this proposal is still under development and specifically relates to those proposals which are identified as falling under the User Pays principle of funding, we consider that the provision of robust cost estimates earlier in the process could become established best practice and adopted for any modification proposal which has a material systems impact.

**3.23. We would welcome views on whether there would be benefits in adopting a uniform approach across codes to the issue of central systems management. In particular, we would welcome views on whether all the**

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<sup>2</sup> Examples of amendments where this has been the case include UNC modifications 88: 'Extension of DM service to enable Consumer Demand Side Management' and 115: 'Correct Apportionment of NDM Error'.

**relevant code administrators be made responsible for the associated systems, or whether this role should be a separate role.**

**3.24. We would also welcome views on whether there are alternative ways of ensuring that the information on system costs necessary to fully analyse modification proposals is made available in a timely fashion by the system manager.**

3.25. It should be noted that any change under which code administration and systems responsibility were merged under the UNC would require careful consideration of the costs and benefits. It would also raise issues relating to how systems are funded under the UNC arrangements. As we set out in Appendix 2, systems costs (as incurred by xoserve) are currently subject to price control regulation through the gas transporter price controls<sup>3</sup>. If the code administration and systems responsibility under the UNC were merged consideration would need to be given to the governance and funding structures of the merged organisation. We consider that this would be a significant change which would require considerable industry involvement and support if it were taken forward.

3.26. Similarly, in the event that systems and code administration were separated under the BSC issues would arise as to how the separate codes and systems administrators would be funded and governed. This would also be a significant change which would require considerable industry involvement and support for it to be taken forward.

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<sup>3</sup> Other than for user pays services.

## 4. Governance and funding

### Chapter Summary

This chapter points out the widely varying approaches to the governance of code administrators that currently exist and asks whether there would be advantages in ensuring some minimum degree of independence between all code administrators and their relevant network owner(s). It also discusses whether there would be advantages in harmonising the way in which code administrators are funded, to improve accountability and transparency in this area.

### Question box

**Question 1:** Should code administrators be independent of network owners? If so, is it sufficient to have management unbundling or should the code administrator be an independent company?

**Question 2:** Should all the major commercial codes have the same corporate governance structures? What is the most appropriate governance structure?

**Question 3:** Are code administrators and the management teams for CUSC, UNC and BSC sufficiently accountable in terms of their costs and performance? Do they have clearly defined objectives and measurable performance targets?

**Question 4:** Code administrators are currently funded by cost pass through, service contracts or price controls. Which of these funding arrangements is the most transparent and accountable?

**Question 5:** Is there an argument for considering the service contract approach to funding for more codes if a degree of self governance for a code is introduced?

**Question 6:** Should the funding of the code administrators for the CUSC and UNC be removed from the relevant network owner price controls?

### Context

4.1. As described in the Brattle review of code governance, the governance arrangements vary quite considerably between the various codes. There are two issues that we consider worth exploring in the context of this review that relate to the governance of the code administrator and its funding arrangements, namely:

- the independence of the code administrator; and
- the funding arrangements of the code administrator.

4.2. We also consider in this chapter the importance of clearly defined objectives, outputs and targets for code administrators and their staff to ensure that they are accountable for their performance.

#### *Independence of code administrators*

4.3. In several cases the administration of the industry codes is undertaken by network businesses and is therefore not managed as a separate independent function. This has the potential to create conflicts of interest which are discussed further below.

4.4. In the case of the CUSC, Grid Code and STC, NG acts as code administrator. We consider this has the potential to create conflicts of interest. Whilst we have received no reports of concern in this area, it is possible to envisage circumstances in which a party considers that a code administrator has a conflict of interest. This particular risk could manifest itself in the drafting of modification reports and the management of code meetings. We would also note that given the introduction of offshore transmission arrangements the number of transmission network owners is likely to increase. This could mean that allowing code administration to be carried out by a single transmission owner may become unacceptable and suggests that a review of the code administration arrangements for the CUSC, the Grid Code and the STC is timely.

4.5. In the case of the UNC, the code administration function is undertaken by the Joint Office ('JO'), which is staffed by employees of the gas transporters. However, the staff are required to act independently in the performance of services to the Joint Office under the terms of the Joint Governance Arrangements. Nevertheless, it is relevant to consider whether more independent governance arrangements should be introduced.

4.6. At the opposite end of the spectrum, the code administration function for the BSC, SPAA, MRA, iGT UNC and DCUSA is already carried out by independent companies.

#### *Funding arrangements for code administrators*

4.7. The second key issue relates to the appropriate funding arrangements for code administrators. At present these include:

- direct pass through of costs (BSC)
- service level contracts (SPAA, MRA, Distribution Code, DCUSA, iGT UNC)
- price control funding (CUSC, Grid Code, UNC, STC).

4.8. The extent to which changes to the governance and funding structures are appropriate or necessary will depend to some extent on whether changes are made to the role of code administrators in relation to code modifications.

4.9. As discussed in the previous section, we consider that there might be merits in giving a greater role to the code administrator either as a “critical friend” or as an “active secretariat”. This, in conjunction, with the potential introduction of self-governance for some modifications means that the need for the code administrator to be an independent body is likely to be significantly increased. An enhanced role for code administrators is also likely to increase the need for transparency and accountability with regard to their funding arrangements. Further, to the extent that we discuss the introduction of company board structures (as set out below) for code administrators, funding arrangements for these companies would also inevitably need to be considered.

4.10. We therefore consider it appropriate to consult on potential changes to the governance and funding structures for code administrators that would enhance their independence, accountability and transparency.

### Corporate governance options

4.11. We set out below three different corporate governance options for code administration:

1. **Close integration between the code administrator and the relevant network owner(s)**. As noted above, this is the option that applies in respect of the Grid Code, the CUSC, the UNC and STC and represents the status quo for the administration of these codes.
2. Some integration between the code administrator and the relevant network owner(s) but with **management unbundling (ring fencing)**. Under this option, there would be rules governing the operational separation between the code administrator and the network owner that ensure clear, transparent accounting and rules regarding staffing to minimise the possibility that the network owner will be able to influence the actions of the code administrator. In practice, this means that the code administrator would need to be a separate business unit with “Chinese walls” between it and the other business units of the network owner.
3. **Independent company and board structure**. Under this option the code administrator is a company independent of the network owner(s), with its own board of directors, although the code panel may contain representatives of the network owner(s). For example, the code administrator could also be appointed for a fixed term by the network owner(s) (and also potentially, market participants) following a competitive tender. The board would be subject to company governance and reporting requirements and the company would need to be established with clear objectives and performance measures.

### *Discussion of the options*

4.12. There are a number of disadvantages with the first option. As noted above there is clearly the potential for the network owner unduly to influence the actions of the code administrator. This potential disadvantage is likely to become more significant if self-governance is introduced, since the need for the code administrator to act in an independent fashion will be significantly increased.

4.13. The possibility for the network owner to exercise undue influence is enhanced if the code administrator is also responsible for managing the code related systems. The disadvantages of this approach may be mitigated to some extent if the code administrator is jointly run by several network owners since they may not always face the same incentives.

4.14. The second option provides some reassurance that the code administrator will act in the interests of all code signatories and not just those of the relevant network owner(s). It corresponds, in part, to the way in which the JO operates, in that the Joint Governance Agreement specifies that staff seconded to the JO must act independently and that the company from which the secondee comes will not seek to influence the secondee.

4.15. The third option ensures an arm's length relationship between the code administrator and the relevant network owner(s) and should increase the level of independence and accountability for the code administrator. It also ensures that the code administrator is subject to the rigours of company governance and reporting. This in turn should provide more transparency over the functions and costs of the relevant code administrators.

4.16. On the other hand, it would require significant changes to the code administration of the CUSC and UNC<sup>4</sup>. A key issue is therefore whether the introduction of corporate structures is a proportionate response to the problems outlined above, particularly if the administrators for these codes continue to have no responsibility for the code systems. This is because, without systems responsibility, the number of people involved in administering the codes is currently small: 2 full time equivalents ('FTEs') for the CUSC and 6 for the JO. However, to the extent that the role of the code administrators is enhanced, it is possible that their resource and staffing requirements will also increase.

**4.17. At this stage, we have no views on which option is preferable. We would welcome views on the options set out above and on which option should be applied to the CUSC and UNC. As Elexon is already constituted under a company structure through the BSC, we discuss it further below.**

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<sup>4</sup> In the June document, the Authority decided that the Review should not explore the possibility of independent board structures for the Grid Code or the Distribution Code.



*Different models for independent company structures*

4.18. Currently there are examples of two different ways in which an independent code administrator can be created. For the SPAA and MRA, two companies (SPAA Ltd and MRA Services Company) have been set up which are wholly owned on an equal share basis by each of the companies to the agreement. These companies have outsourced their code administration responsibilities to independent companies (Electralink and Gemserv respectively). These independent companies were appointed for a fixed term following a competitive tender. The service contracts are managed by the Executive Committees of the SPAA Ltd and MRA Services Company, whose members act as company directors. The use of competitive tender processes such as this has considerable benefits in terms of providing incentives on the administrator to efficiently manage costs and provide high quality services.

4.19. Elexon, on the other hand, is a wholly owned subsidiary of NG but has been deliberately set up so as to act as an effectively independent company, in the sense that it is independently managed and staffed and has an independent board of directors. The chairman of the board is also the chairman of the BSC Panel and is appointed by Ofgem. The chairman, in turn, appoints two independent non-executive directors, and two of the industry members of the BSC Panel are nominated by the Chairman in consultation with the Panel, as directors of the board. The day-to-day operations are managed by a chief executive, who is appointed by the board after consultation with the BSC Panel.

*Clearly defined objectives and deliverables*

4.20. For any of the models set out above to work effectively it will be important to ensure that the code administrators for the CUSC and the UNC have **sufficiently defined and clear objectives governing its performance on costs and quality of service**. Further these objectives should be accompanied by performance targets and incentives on **senior staff of the administrator** for the delivery of the code administration objectives. These could include cost, quality of analysis and timescale targets.

4.21. We also consider that the creation of board and company structures could provide the most optimal framework for ensuring that objectives are sufficiently defined and that performance can be effectively measured.

4.22. We would welcome views on the extent to which the administrators of CUSC and UNC have clearly set objectives and measurable performance targets and whether improvements can be made in these areas. We discuss Elexon further below.

*Elexon Board – a review*

4.23. In the June document, we undertook to review the Elexon board framework, since it is the only major commercial code with an independent board. Our view is that the board provides an important discipline on the Elexon management team

both generally and in terms of budgets. This is particularly the case for the systems element of Elexon's role, where the board provides a useful oversight in terms of systems procurement and commercial negotiation strategies. On the other hand, there is little transparency regarding the activities of the Elexon board: for example, no material relating to the decisions that it reaches is published nor are minutes of its meetings published. Whilst we accept that it would be inappropriate to report details of discussions regarding approaches to commercial negotiations, there seems no obvious reason why at least partial minutes could not be published for transparency purposes.

4.24. Another observation on the Elexon board structure is that the chairman of the board is also the chairman of the BSC Panel. In this respect, it is relevant that the chairman has the casting vote on the BSC Panel, if the BSC Panel voting would otherwise be tied. Whilst there is no suggestion that the incumbent chairman's views on any modification have been unduly influenced by the implications that it would have for Elexon and the BSC systems more broadly, a constitutional separation of these roles may assure impartiality irrespective of future appointments.

4.25. More generally, there may also be issues regarding the incentives on the Elexon Board and senior management to manage costs effectively given that these costs are passed through to industry participants. Whilst there is transparency around Elexon's budget and corporate strategy, a key question is whether the cost pass through framework provides it with sufficient incentives to manage costs efficiently and to deliver high quality services. This is an issue we are seeking views on and is discussed further below under the heading "Funding Arrangements".

4.26. We are also interested in seeking views from respondents on whether there is a sufficiently defined set of objectives, deliverables and performance measures for Elexon against which its performance can be measured and against which its management team can be provided with performance targets governing cost, timescale and quality targets. Such a performance framework could be reported on an annual basis through Elexon's annual report. Elexon currently publishes a three year business plan and strategy each year. We are interested in respondents' views as to whether this document provides a sufficiently defined set of objectives, deliverables and performance measures.

**4.27. We would welcome views on the governance of Elexon including:**

- **whether there are sufficient incentives on Elexon to manage costs and quality of service; and**
- **whether Elexon has a sufficiently defined set of objectives, deliverables and performance measures against which its performance can be managed.**

**4.28. We would also welcome views on whether or not it is appropriate for the role of Elexon board chairman and BSC Panel chairman to be combined.**

## Independent chairmen

4.29. A simple mechanism for ensuring that there was at least some degree of independent oversight for code administrators would be to require all major commercial code Panels and boards to have an independent chairman, appointed by Ofgem. The main codes that would be affected are the CUSC and the UNC. We would welcome views on whether such a change would be sufficient to minimise any potential for conflicts of interest.

## Funding arrangements

4.30. As outlined above, there are currently three different types of funding arrangements for code administrators: pass through, service contracts and price control funding. To the extent that board/company structures are adopted for the administration of the UNC and CUSC, it will be necessary to consider the funding arrangements underpinning these structures. It should be noted that in our June document we specifically ruled out exploring service contracts or price controls for the code administrators for CUSC and UNC. However if we are to consider company structures then the funding of any new administrator companies will need to be addressed. In addition, we would also welcome views from respondents on the adequacy of the existing funding arrangements for Elexon and whether these should be changed. We evaluate the three approaches further below.

4.31. **Cost pass through mechanisms.** Allowing a code administrator to pass through the costs that it incurs provides for a high degree of independence and transparency. It should also, in theory, result in a high level of service since there are no advantages to be gained from cutting corners. On the other hand, it provides no incentives to improve efficiency. It should be noted that in the case of Elexon, whilst a cost pass through mechanism exists, there is nevertheless significant transparency around Elexon's costs and budget with accountability being provided through Elexon's board structure. Elexon also consults on its Corporate Strategy each year.

4.32. **Service contracts.** The service contract approach has worked well for the several of the newer codes, namely the SPAA, MRA, DCUSA and iGT UNC and is a mechanism through which the code owners (potentially through the code panels) can ensure, via a commercially tendered and negotiated framework, accountability for service and cost levels. It is difficult, however, to tell whether the success of the approach has been due to the nature of the codes, which are largely technical in nature since they deal with changes of supplier in the gas and electricity markets. As such, they are not subject to as many modifications as some of the more major codes and the modifications that are raised tend to be of a more limited scope. Nonetheless, service contracts could provide industry with a greater degree of control and accountability over the actions of code administrators.

4.33. **Price control approaches.** Recovering a code administrator's costs as part of the price control for the relevant network owner(s) should provide incentives for efficiency. These might however be at the expense of quality of service and as such,

separate incentives or output measures might need to be established to maintain service quality. It is also noted in this respect that we consider service quality is a key element of the code governance arrangements. Indeed, one of our key concerns with the governance arrangements (as we have set out above) relates to deficiencies in service quality, for example in the preparation of code modification reports. A further key consideration is whether it would be proportionate separately to price control code administrators given the level of costs and the size of any regulated cost base.

**4.34. We would welcome comments from respondents on the advantages and disadvantages of the approaches to funding set out above, including in particular whether there are preferred approaches for the funding of a UNC and CUSC code administrator and whether respondents believe that the existing funding arrangements for Elexon should be changed from the “pass through” approach to an alternative approach.**

## Mergers of Code Administrators

4.35. Whilst we consider that there could be efficiencies gained from merging the activities of two or more of the existing code administrators, in the June 2008 document setting out the scope of the Review the Authority recognised that initiating such a merger is likely to be a substantial and resource intensive exercise. Based on the earlier responses received to the governance Review, in particular from the November 2007 consultation, there did not appear to be sufficient support from industry participants to pursue that option at this time.

4.36. We also note that there are already instances of more than one code being administered by the same service provider, for instance the SPAA and DCUSA are both administered by Electralink. We therefore do not preclude the potential for further efficiencies of scale and scope to be sought, whether through formal mergers, procurement of services through competitive tender, or otherwise. However, our current view is that these issues should appropriately be considered by the relevant parties, particularly those who provide funding as described above.

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## 5. Other potential improvements

### Chapter Summary

In addition to the potential changes to code administrators discussed in the preceding two chapters, there are a number of more incremental changes that could be made to the way in which code administrators and panels work. This chapter discusses four such possible changes and invites views on them.

### Question box

**Question 1:** Should Ofgem have powers to “call in” and “send back” modification proposals? What are your views on the “call in” and “send back” options?

**Question 2:** Should all code Panels have to publish the reasoning behind their recommendations?

**Question 3:** Should code administrators be able to raise modifications themselves? If so, should there be limits on what modifications they can raise or should they have to gain the consent of the code Panel to the raising of the modification?

**Question 4:** Would it be useful to develop a code of practice applying to all code administrators? Should it be voluntary or binding?

**Question 5:** What are the most appropriate mechanisms to evaluate the performance of code administrators? Is a scorecard approach appropriate?

### Context

5.1. Many of the options outlined in the preceding sections would involve quite significant changes to the governance arrangements of some of the codes. There are, in addition, some more incremental and light-handed changes that could be made relatively quickly. These changes could supplement the more significant changes discussed in Chapters 3 and 4 or alternatively be introduced independently. The options include:

- the ability for Ofgem to **call-in** and **send-back** modifications;
- requiring all code **Panels to provide reasons for their recommendations**;
- enabling **code administrators to raise code modifications**;
- introducing a **code of practice** for all code administrators; and

- creating **performance evaluation measures** for code administrators.

5.1. None of these options are contingent on the other proposals contained in this document.

### **“Call in and send back” proposals**

5.1. The June document promised that we would consult on introducing the power for Ofgem to:

- **“call in”** modifications when Ofgem considers that the progress of a modification is too slow or inadequate (or deficient) analysis is being undertaken; and
- **“send back”** modifications sent to Ofgem for decision when the analysis undertaken is deficient.

5.2. The “call in” option would enable Ofgem to call a code panel to account particularly with regard to the slow progress of a code modification. In addition, as it may not always be possible to determine fully the scope of analysis required when a modification is first raised, the call in option would provide another route (beyond Ofgem providing assistance early in the industry assessment process) for Ofgem to provide guidance on what is required.

5.3. If a modification were “called in”, we envisage that the outcome would be one or more of the following types of action:

- the panel would agree with Ofgem a timetable for the completion of the modification process; and/or
- the terms of reference for the modification group (or work-group) would be revised to ensure that an adequate assessment will be carried out; and/or
- the panel would agree with Ofgem what steps should be taken to remedy the defects that Ofgem has identified with the analysis performed so far.

5.4. If a modification were to be sent back, then we envisage that Ofgem would provide details of the areas where it felt that the assessment was deficient and the means by which the deficiency might be remedied.

5.5. We consider that the introduction of a “send back” power has a number of advantages:

- Whilst Ofgem can already provide input regarding the assessments that it considers necessary (and has), it is not always possible to do this early in the process. For example, it may not be until Ofgem has closely analysed a modification proposal once it has been submitted that the deficiencies in the

analysis become apparent. In addition, Ofgem may not always have sufficient resources available to identify concerns early in the modification process and it is always possible that new issues will come to light, particularly through relevant developments elsewhere. The “send back” option therefore provides the flexibility for the deficiencies to be addressed at this later stage before the modification decision is issued.

- The “send-back” option could avoid the inefficiencies of Ofgem having to reject the modification and the modification proposal having to be re-raised as a new proposal. Consequently, the changes should help to streamline the modification process, prevent unwarranted delays occurring and prevent analysis having to be repeated.

5.6. We consider that the introduction of these options would require amendments to licences.

#### **5.7. We would welcome views on these options.**

### **Requirements on panels to provide reasons for their recommendations**

5.8. In our June document we undertook to consult on requirements for code panels to give reasons for their recommendations to the Authority on modification proposals. We consider that imposing a requirement on code panels to provide reasons for their recommendations would add transparency and clarity to the modification process and act as a useful discipline on panel members by requiring them to explain their thinking in respect of particular modifications. Some code panels, such as the BSC Panel, already provide such information, by making reference to the BSC Objectives that they think would or would not be better facilitated by a particular modification. In other cases however, such as CUSC and UNC, explicit reasons are not always provided.

5.9. We also consider that if self-governance is introduced, it will be particularly important that the reasoning of code panels is recorded, since they will be acting as decision making bodies.

5.10. We consider that the introduction of requirements on code panels to provide reasons for their recommendations could be introduced through licence amendments. Such amendments might, in turn, necessitate code changes.

### **Allowing code administrators to raise modifications**

5.11. Code administrators may be well placed to identify parts of their code which are inefficient, redundant or not in line with the relevant code objectives. Under such circumstances, it could be appropriate to allow the code administrator to raise a modification directly rather than relying on the administrator finding a code signatory

willing to raise the necessary modification. Indeed, such a role and power could supplement the “active secretariat” option discussed previously in Chapter 3.

5.12. Some code administrators do have limited powers to suggest modification proposals. For example, Elexon carries out periodic reviews of the BSC, focusing on process related issues. Where it identifies that there is a deficiency in the code, it brings the matter to the attention of the BSC Panel, who can then raise an appropriate modification. However, the BSC Panel’s role in this respect is limited to raising proposals that would promote efficiency in the implementation and administration of the balancing and settlement arrangements.

5.13. Were code administrators to be allowed directly to raise modifications, there would be a number of issues that would need to be considered. For example, potential conflict of interest issues would need to be addressed to the extent that the entity performing the code administration function also undertook other functions such as systems management. In this case however it is arguable that the examination of the modification by the code panel and the modification group should provide sufficient independent input to overcome any bias from the code administrator.

## Code of practice

5.14. At present, there is no formal mechanism whereby best practice in a particular area of code and/or system administration can be recognised and widely adopted. The CAWG is currently considering whether this could be addressed by introducing a code of practice for code administrators.

5.15. The purpose of the code of practice would be to ensure consistency of approaches across codes with all code administrators adopting what was agreed to be best practice in a particular area. At present, the variety of different procedures and processes increases the difficulties for market participants (including smaller participants and consumers) in keeping abreast of what is happening across the range of codes. Greater consistency would have the benefit of making it easier for participants with familiarity with only one code to get to grips with other codes, should that become necessary.

5.16. Areas that a code of practice might address include:

- creation of standard pro-forma documents for modification proposals and code modification reports;
- a requirement to include “plain English” summaries of modification proposals and panel assessments;
- agreed standards and principles for the layout and content of code administrator websites;



- alignment of code change process terminology where appropriate;
- roles and responsibilities for code administrators in respect of small participants; and
- factors that code panels (and administrators) will take into account in assessing code modification proposals against the relevant objectives.

5.17. Whilst the concept of the code of practice has been suggested by some members of the CAWG we would welcome wider views from respondents on whether a code of practice would be helpful and, if so, what areas it should cover.

5.18. A further important issue, in respect of a code of practice, is whether it should be voluntary or binding. In principle, there is nothing to stop code administrators developing a voluntary code of practice at the moment so this should be achievable if there is broad support for the concept. However, we would welcome views on the effectiveness of a voluntary agreement. It may be the case that code administrators should be required to agree and comply with the code of practice for it to have a meaningful effect and for it to provide benefits.

## Performance evaluation measures

5.19. In the June document, we stated that we would consult on whether performance evaluation measures for code administrators should be introduced. Our idea was to provide some means of benchmarking the relative performance of code administrators.

5.20. We accept that it is not straightforward to develop performance evaluation measures that provide meaningful comparisons between different code administrators. This is because code administrators have no control over the number or type of modifications that are raised and yet this can have a significant effect on the costs incurred and time taken in processing a modification. Moreover, the role of different code administrators in relation to modifications also varies. For example, Elexon has to produce central cost assessments and provides legal advice and legal text whereas the JO does not.

5.21. For this reason, our initial view is that qualitative performance measures are likely to be more appropriate than quantitative ones. One possibility would be to develop a “scorecard” for code administrators. The scorecard could provide qualitative assessments e.g. a rating between 1 and 5, of each code administrator for a number of different dimensions rather than a direct quantitative comparison such as the average cost per modification. Elements of code administrators’ performance that could be included on the scorecard include cost efficiency, timeliness (processing of modifications), quality of reports and analysis, and level of industry satisfaction. Ofgem might publish a scorecard for each administrator every two years or so. In doing so, it would seek the views of interested parties and might commission external studies into particular dimensions e.g. cost efficiency.

5.22. If a code of practice were introduced, then a further dimension might be adherence to the principles that it contained. Indeed, the introduction of a code of practice with consistent standards for code administrators should help to facilitate effective comparisons on performance across the administrators.

5.23. We would welcome views on whether performance evaluation measures should be introduced and, if so, whether “soft” measures are appropriate. We would also welcome suggestions from respondents on other possible performance evaluation measures.

## 6. Small participants, new entrants and consumer representatives

### Chapter Summary

This chapter explores ways in which the needs of small participants, new entrants and consumers might better be met. At present, we are concerned that the complexity and fragmentation of the code modification processes makes it difficult for these types of parties to engage with the code governance arrangements in a meaningful way. The chapter suggests four main approaches that could be taken to improve the situation and asks for views on which, if any, of them would be appropriate.

### Question box

**Question 1:** Do small participants, new entrants and consumer representatives face significant hurdles in engaging with the code governance processes?

**Question 2:** What are the key issues that need to be addressed in order for small participants and others to better engage with the code governance processes?

**Question 3:** Do you have any views on the options highlighted in this chapter? Do you have any views on the advantages and disadvantages discussed under each option?

**Question 4:** Which options, if any, do you consider will allow small participants and others to engage better with the code governance processes?

**Question 5:** Are there other options which we have not yet considered which may assist small participants and others to play a fuller part in the codes governance processes?

## Background

6.1. In the June document, we indicated that the fragmented and complex nature of the codes arrangements represents a barrier to new entrants and small market participants engaging in the codes process. We also indicated that these parties have less resources and less ability to influence change than the incumbent energy companies.

6.2. We indicated that if small participants and new entrants experience difficulties in committing resources to the codes then they are less likely to raise code changes, which may bring pro-competitive benefits. In setting out these concerns we are particularly conscious of the changing market landscape and the entry of smaller players, including renewable and distributed generators as well as suppliers. Our

concerns also extend to consumer representatives who can experience the same difficulties in engaging in complex code processes.

6.3. We therefore outlined our intention to explore ways to better meet the needs of small participants and new entrants as well as those representing consumers when they engage with the codes processes.

6.4. Specifically, we said that we would consider whether:

- there should be some requirement on code administrators and panels to consider the needs of small participants and others in the context of the administration of the codes modification processes; and
- whether there are particular types of funding arrangements, e.g. a central industry-based fund, which could be established to assist in meeting these needs. Small participants and others would be able to draw upon such resources to allow them to take a fuller part in the codes change workgroups and also allow them to develop their own modification proposals.

6.5. In this chapter, we explore these issues in more detail and set out some potential options for increasing the inclusiveness and accessibility of the codes governance processes for small participants, new entrants and consumer representatives. The options we set out may improve on and allow the existing processes to better meet other principles of good governance such as transparency, accountability, and efficient and effective change management.

## Current situation

### *Small participants*

6.6. Currently, there are no provisions within the major codes which specifically allocate panel membership or voting rights to small participants (including small suppliers, shippers, users and generators). However, an individual working for a small participant could be elected to the BSC Panel, to the CUSC Panel, or to the UNC Panel if they could obtain enough support from industry participants. The BSC Panel chairman may appoint a sixth industry BSC Panel member if he considers that a class or category of trading parties (or parties which are exempt from holding a licence) is not represented on the Panel<sup>5</sup>. Under other industry codes, such as DCUSA and iGT

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<sup>5</sup> Under these powers the BSC Chairman has appointed Professor Catherine Mitchell to the current Panel, see: <http://www.elexon.co.uk/bscpanelandcommittees/panelmembers/default.aspx>

UNC, classes of parties are represented on the Panel which could include representatives of small participant parties.

6.7. Small participants who are also code parties can raise change proposals to the relevant codes.

### ***Consumer representatives***

6.8. The role of consumer representatives in the GB industry codes is clearer and more explicit than for small participants, taking the form of membership of some of the code panels and also the right to raise change proposals under some of the codes.

6.9. From 1 October 2008, Consumer Focus has had the right to appoint up to two BSC Panel members and one CUSC Panel member, in each case with full voting rights. Consumer Focus also has the right to appoint up to two members of the UNC Panel but without voting rights. Other industry codes (DCUSA, iGT UNC, MRA, SPAA) allow Consumer Focus to attend panel meetings with the right to speak but not vote. Consumer Focus has an explicit right to raise change proposals under the following codes: the BSC, the CUSC, the DCUSA and the SPAA. It is also designated as a “third party” by the Authority for the purpose of raising change proposals (relating to the table of operational and market data) under the UNC and the iGT UNC.

### **Key issues**

6.10. There are benefits arising from small participant and consumer representation on the code panels and through their ability to raise change proposals<sup>6</sup>. Panel membership allows those representatives to express views on issues arising under the relevant codes at panel proceedings. Where there are also voting rights attached to panel membership, the representative has the opportunity to influence the panel's recommendations to the Authority on change proposals, some or all of which may have an ultimate impact on those participants or consumers. Where a specific issue affecting small participants, new entrants or consumers is identified, there may be an opportunity to raise a change proposal to address that issue.

6.11. Whilst Consumer Focus has the ability to vote and raise modifications under CUSC and BSC, we are concerned that equivalent rights do not exist under the UNC. We consider that there is also a case for ensuring that small market participants, as a category of industry player, have specific representation rights on BSC, CUSC and UNC panels.

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<sup>6</sup> Energywatch (the precursor of Consumer Focus) raised three modifications: one to the BSC and two to the UNC.

6.12. We are also concerned that there is little or no engagement by small participants and consumer representatives on code modification workgroups. This is a particular deficiency in the existing processes because workgroups are responsible for assessing change proposals and developing the solution(s) which may ultimately be recommended by code panels. A lack of involvement from certain representatives may create gaps in the assessment of change proposals and may fail to take into account the views of certain significant stakeholder groups, especially if those proposals have a high impact on them.

6.13. There may be various reasons for a lack of engagement by small participant and consumer representatives:

- They may find the **processes to be opaque** and difficult to engage with. The Brattle Critique highlighted that the operation of the code processes and the way that analysis is presented in modification reports may make them difficult to understand for small participants, new entrants and consumer representatives.
- They may be **resource constrained** and unable to keep track of all modification proposals that are likely to affect them. Resource constraints may also limit their ability to develop expertise regarding the codes. This may prevent them from responding to consultations let alone acting as modification group members, which requires a high level of commitment.
- They may feel that there is no point in being a modification group member because their **views may carry little weight**. For example, in BSC modification group's decisions regarding the development of the original modification or the inclusion of alternatives are reached by simple majority voting. The views of small participants and/or consumer representatives may differ from those of other larger incumbent industry participants and hence they can effectively be ignored.

6.14. Below, we outline three possible options for facilitating the involvement of small participants, new entrants and consumer representatives in code governance, and discuss their advantages and disadvantages.

#### *Definition of small participant*

6.15. In setting out the options below, it is important to consider an appropriate definition of a small participant. This is necessary particularly as many of the options set out below would confer particular rights and entitlements on parties falling within this definition. Ofgem would welcome views from industry participants on how "small participants" should be defined. For example, the definitions might be related

to the existing licence exemption thresholds. Under this approach, the following definitions would apply for electricity<sup>7</sup>:

- **generators:** participants who do not at any time provide more electrical power from any one generating station than 10 MW or 50 MW if the station has a declared net capacity of less than 100 MW;
- **suppliers:** participants who do not supply any electricity except electricity which they generate themselves and who do not at anytime supply more electrical power than 5 MW of which not more than 2.5 MW is supplied to domestic consumers; and
- **distributors:** participants who do not at any time distribute more electrical power than 2.5 megawatts for the purpose of giving a supply to domestic consumers or enabling a supply to be so given with that electrical power.

6.16. We would welcome views on the possible approach set out above and how it might be applied to the gas market.

***Option 1: Status quo “plus”***

6.17. This option would simply involve making relatively minor adjustments to the current processes.

*Improved panel representation*

6.18. One example of such an incremental change would be to **ensure that there is a seat with voting rights for a Consumer Focus representative on each of the major code panels**. This would mean extending the rights that Consumer Focus currently has under the BSC and CUSC to the UNC.

6.19. Such a change would provide Consumer Focus with a greater input into the UNC code processes provided that it is able and willing to provide sufficient consumer representatives with the experience and knowledge necessary to make a useful contribution.

6.20. Similarly, small participants could be provided a designated seat on each of the BSC, CUSC and UNC with voting rights on the panels to ensure that their interests were protected in the industry assessment process on modifications.

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<sup>7</sup> The Electricity (Class Exemptions from a Requirement for a Licence) Order 2001.

### *Working group engagement*

6.21. However, neither of the above initiatives would address the issue of a lack of participation at the modification group level. By the time, a modification comes to a code panel for a decision, its details have been decided and its assessment completed. Whilst the panel will have an important role in shaping the terms of reference for the assessment process, the role of the work-groups (or work-streams) can be critical to the progression of modifications.

6.22. Another example of incremental change is that the **code administrators could (for example, via a reasonable endeavours obligation) be required to take steps to ensure that a broad range of views, including those of small participants and consumer representatives, are obtained on modification proposals, including through the work-group/work-stream processes.** This engagement could take place in a number of ways:

- contacting relevant small participants/consumer representatives when a proposal raises issues that may impact on their group;
- holding remote rather than 'live' meetings, if this is more convenient for them;
- raising the issues at appropriate industry meetings, for example at Ofgem's Demand Side Working Group; or
- through establishing web-based forums.

6.23. Any views provided through this 'awareness raising' approach would be reported back by the code administrator to the modification group/work-group and the relevant panel, and taken into account in the final assessment report. This approach could also sit alongside the role of the code administrator as a 'critical friend' or 'active secretariat' as discussed in Chapter 3. However, as noted above, voting arrangements within modification groups/work-groups may still mean that the concerns of small participants carry little weight.

6.24. Working outside of the constraints of a modification group, particularly if the interaction can be done remotely, may enhance the opportunities for small participants and others to engage in code processes. On the other hand, there would be resource implications for code administrators from such a requirement and it would be difficult to assess how well such a requirement was being met. A code administrator might make considerable efforts to elicit views without receiving any responses.

### ***Option 2: Establishing a separately funded and administered Advocacy Panel***

6.25. The Australian energy market arrangements provide for the establishment of an independent Consumer Advocacy Panel with membership drawn from those with



relevant sector knowledge and consumer advocacy experience. The Panel administers a fund from which consumer advocacy and energy user groups can draw by applying for monies for funding specific advocacy projects. Applications are assessed by the Consumer Advocacy Panel against an agreed set of criteria. The Consumer Advocacy Panel may also undertake and publish its own research on issues which impact on consumers.

6.26. The Consumer Advocacy Panel approves or rejects applications for full or part funding of projects depending on whether the criteria are met, including whether the funding provided is likely to be spent efficiently and economically. Independently audited post-project reviews take place to monitor and determine whether projects have been successfully implemented or not.

6.27. The most recent budget allocated to the Panel for electricity advocacy was AU\$1.925 million (around £800,000). Funding is provided jointly by the Australian Energy Market Commission (the body responsible for the development of the National Energy Market rules) for projects which would benefit gas consumers and by the national electricity market system operator (NEMMCO) for projects of potential benefit to electricity consumers. Further details of these arrangements are set out in Appendix 4.

6.28. Establishing an equivalent arrangement for the GB energy markets through a centrally provided and industry funded pot would allow appropriate financial assistance to be provided to advocacy groups representing small participants, new entrants and consumer representatives who may otherwise be unable to engage with the change process under the various industry codes due to resource constraint and prioritisation issues.

6.29. Other than making use of industry associations (the Chemical Industries Association, the Major Energy Users Council etc.), the only current way for such groups to obtain advocacy services is for them to pay for the services of specialised private companies offering this type of support. Whether this is a realistic option will depend on the organisation's budget. Establishing a fund for advocacy would provide additional resources which would overcome, at least in part, some of the existing constraints.

6.30. The advantage of such an approach is that the disbursement of any funds would be vetted against a fixed set of criteria, which should ensure that resources would be distributed on an efficient and transparent basis. It would provide a flexible means of encouraging participation since the way in which funding was provided could be varied to suit individual circumstances. It would also potentially enhance the role that could be played by existing advocacy sources.

6.31. We would envisage that, if implemented, funding a GB Advocacy Panel for consumers, small market participants and new entrants, would be drawn from industry participants.

6.32. The main disadvantage of this option is simply that there would be a significant number of issues to resolve if it were adopted so that there is a question as to whether it provides a proportionate response to the problem. Issues that would need to be resolved include:

- the precise nature of any industry funding arrangements;
- who would establish and appoint the Advocacy Panel and what criteria would be used to determine membership of the Advocacy Panel;
- how the size of financial ‘pot’ from which the Advocacy Panel would distribute monies to approved projects would be determined and how it would be funded;
- who would be eligible to apply for funds and what eligibility criteria would they need to meet to receive funds;
- what assurances would funding recipients be required to provide about the use of the allocated funds and how would post-project reviews be carried out; and
- would assistance be provided to certain groups who are seeking funding to develop their application to meet the relevant criteria and, if not, would this create a ‘barrier to entry’?

***Option 2a: Consumer Focus administers the Advocacy Panel funding ‘pot’***

6.33. Under this variant of Option 2, Consumer Focus would be designated as the body which administers the Advocacy Panel fund. This would reduce the work required to establish the Advocacy Panel since many of the members could be drawn from Consumer Focus. However, it would still be important to appoint members of the Advocacy Panel to represent the interests of larger consumers<sup>8</sup>, small participants and new entrants. It would also be important to ensure that the Advocacy Panel fund was appropriately ring-fenced from Consumer Focus’ budget for its other activities.

6.34. There would be a risk that small participants and new entrants feel that the appointment of Consumer Focus to administer the arrangements would create a bias towards consumer advocacy groups and their projects rather than an objective

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<sup>8</sup> Consumer Focus acts as an advocate for all existing and future energy consumers with particular regard to the interests of specified groups of vulnerable individual consumers.

assessment of all applications. Moreover, if Consumer Focus were to administer the Advocacy Panel fund it seems likely that it would have to be disbarred from applying for funding itself to avoid conflicts of interest.

6.35. This option might be preferable to Option 2 to the extent that the creation of an Advocacy Panel could be managed from within Consumer Focus as opposed to creating a separate entity. As such, this approach might be more cost efficient.

### ***Option 3: Ofgem's Consumer Challenge Group***

6.36. In January 2007, Ofgem launched a project (Consumer First) to allow us to develop ways in which to take more direct account of consumer interests and opinion in policy-making. This project has led to the establishment of:

- a **Consumer First Panel** consisting of members of the public who help inform our views on major public policy issues arising in the energy sector and affecting domestic consumers, e.g. smart metering, the costs of environmental programmes;
- a **Consumer Challenge Group**, with informed contributors from domestic and business consumer representative organisations, who help to provide a counterbalancing view to the industry on more complex or technical subjects such as price controls. Ofgem pays the expenses of these contributors.

6.37. Under this option, the role of the Consumer Challenge Group or a similarly modelled group would be enhanced to incorporate an advocacy role, whose costs would be funded by Ofgem. As under Option 2a, the risk with this approach is that the interests of small participants and new entrants may not be adequately protected.

### ***Option 4: Introduce a duty on code administrators to advocate on behalf of small participants, new entrants and consumers.***

6.38. This option would place a direct duty on code administrators to provide an advocacy role and to provide assistance to consumer representatives, small market participants and new entrants. The code administrator would ask questions of the workgroup during the assessment of change proposals that would otherwise be asked by those participants who are not able to or are not taking part in the assessment process. Code administrators would be required, by specific reference to their roles in the various codes, to ensure that all possible points of view have been discussed and explored in the report which is presented for panel recommendation.

6.39. To some extent, this option represents an extension of the Option 1 enhancement requiring code administrators to solicit the views of small participants, new entrants and consumer representatives outside of the modification group process. As with that option, it is for consideration whether voting mechanisms

within modification groups/work-groups might mean that the advocacy was ineffective.

6.40. This approach would make most sense if the role of code administrators were expanded to that of “critical friend” or “active secretariat” but the role could be imposed without these changes. In any event, to undertake this role, code administrators would have to ensure that they had a sufficient understanding of the views of small participants, new entrants and consumer representatives.

6.41. In addition to assisting small market participants, new entrants and consumer representatives in engaging in the codes process, this approach should provide a more rounded analysis of modifications, and thus assist in meeting Ofgem’s concerns in regard to the quality of analysis provided.

**6.42. At this stage, we do not have a preference between the options outlined above. We would welcome views from respondents on each of the four options set out above.**

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## Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 27 February 2009 and should be sent to:

- o Mark Feather
- o Director, Industry Codes & Licensing
- o 3<sup>rd</sup> Floor, Ofgem, 9 Millbank, London, SW1P 3GE
- o 020 7901 7437
- o mark.feather@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Any questions on this document should, in the first instance, be directed to:

- o Jonathan Dixon
- o Industry Codes & Licensing
- o 3<sup>rd</sup> Floor, Ofgem, 9 Millbank, London, SW1P 3GE
- o 020 7901 7354]
- o Jonathan.dixon@ofgem.gov.uk

### **CHAPTER: One**

No questions.

**CHAPTER: Two**

**Question 1:** Are the Authority's concerns regarding the quality of analysis undertaken through the code modification processes justified?

**Question 2:** Are some code administrators more accountable than others?

**Question 3:** We consider that code complexity is a problem, particularly for small participants, new entrants and consumer representatives. Do you agree? How can the complexity be reduced?

**Question 4:** Do small participants, new entrants and consumer representatives find it difficult to engage with the code modification process?

**CHAPTER: Three**

**Question 1:** Do you agree that the quality of analysis in code modification reports could be improved? Should the role of the code administrator be changed to help enhance the quality of code modification reports?

**Question 2:** Which of the options for changing the role of the code administrator in the modification process (critical friend or active secretariat) is most appropriate? Should different options be chosen for different codes?

**Question 3:** Should the roles of the administrators of the BSC, UNC, CUSC, Grid Code, SPAA and MRA in respect of central systems management be harmonised i.e. should all code administrators either be made responsible for the related systems or should this responsibility be removed from them all?

**CHAPTER: Four**

**Question 1:** Should code administrators be independent of network owners? If so, is it sufficient to have management unbundling or should the code administrator be an independent company?

**Question 2:** Should all the major commercial codes have the same corporate governance structures? What is the most appropriate governance structure?

**Question 3:** Are code administrators and the management teams for CUSC, UNC and BSC sufficiently accountable in terms of their costs and performance? Do they have clearly defined objectives and measurable performance targets?

**Question 4:** Code administrators are currently funded by cost pass through, service contracts or price controls. Which of these funding arrangements is the most transparent and accountable?

**Question 5:** Is there an argument for considering the service contract approach to funding for more codes if a degree of self governance for a code is introduced?

**Question 6:** Should the funding of the code administrators for the CUSC and UNC be removed from the relevant network owner price controls?

#### **CHAPTER: Five**

**Question 1:** Should Ofgem have powers to “call in” and “send back” modification proposals? What are your views on the “call in” and “send back” options?

**Question 2:** Should all code Panels have to publish the reasoning behind their recommendations?

**Question 3:** Should code administrators be able to raise modifications themselves? If so, should there be limits on what modifications they can raise or should they have to gain the consent of the code Panel to the raising of the modification?

**Question 4:** Would it be useful to develop a code of practice applying to all code administrators? Should it be voluntary or binding?

**Question 5:** What are the most appropriate mechanisms to evaluate the performance of code administrators? Is a scorecard approach appropriate?

#### **CHAPTER: Six**

**Question 1:** Do small participants, new entrants and consumer representatives face significant hurdles in engaging with the code governance processes?

**Question 2:** What are the key issues that need to be addressed in order for small participants and others to better engage with the code governance processes?

**Question 3:** Do you have any views on the options highlighted in this chapter? Do you have any views on the advantages and disadvantages discussed under each option?

**Question 4:** Which options, if any, do you consider will allow small participants and others to engage better with the code governance processes?

**Question 5:** Are there other options which we have not yet considered which may assist small participants and others to play a fuller part in the codes governance processes?



## Appendix 2 – Background to gas and electricity governance

1.1. The new wholesale electricity trading arrangements (NETA) introduced in March 2001 established a different set of code governance arrangements from those operating previously under the Electricity Pool.

1.2. Pool governance was considered to be a hindrance to effective change of the Pool market rules. Under the Pooling and Settlement Agreement (PSA), all licensed generators and suppliers became Pool members, alongside other identified parties, for example, inter-connector users. In order to change the Pool rules, an amendment required support from a percentage of Pool members (in some cases, approval was needed from a certain percentage of a class of Pool members). There were also certain entrenched rights of veto for the benefit of some Parties to the PSA which potentially created a barrier to change.

1.3. NETA aimed to increase efficiency and greater choice for those involved in trading electricity (generators, suppliers, traders and consumers) whilst maintaining the operation of a secure and reliable electricity system by National Grid. NETA governance was based on identifying changes to Pool governance which would underpin the increased emphasis on promoting or facilitating effective competition. Each of the codes developed under NETA – in particular the Balancing and Settlement Code (BSC) and the Connection and Use of System Code (CUSC) – has a competition objective against which proposed code changes are assessed.

1.4. Similarly, National Grid's sale of four regional gas networks in 2005 was accompanied by a significant change. A Uniform Network Code was introduced rather than each network operating under the terms of its own network code. The governance process for the Uniform Network Code was also different to the previous arrangements under which National Grid acted as the code administrator. Provision was made as part of the sales process for a changed Modification Panel with voting rights balanced between gas transporters and shippers, and with a new code administrator body created, the Joint Office of Gas Transporters (Joint Office), which is independent of all players in the gas market. The Joint Office is constituted in accordance with licence conditions which were designed to deliver non-discriminatory, independent, administration of the modification process.

### **Balancing and Settlement Code (BSC)**

1.5. The BSC replaced the PSA. It incorporates a governance structure which is significantly different from, and reflective of, the changed priorities. The BSC contains rules, structures and processes for operating and developing the balancing mechanism and imbalance settlement established through an obligation in National Grid's system operator licence. The licence defines high-level objectives for the BSC against which proposed modifications are assessed. It also provides an obligation on National Grid, the code owner, to establish processes for modification of the BSC and, where the Authority has agreed to a modification, obliges National Grid to implement that modification.

1.6. The BSC governance mechanism comprises:

- a BSC Panel, consisting of an independent chairman (appointed by the Authority), five elected industry members, two independent members (appointed by the chairman), one member appointed by the Transmission Company, and two consumer members (appointed by Consumer Focus). There is a facility for the chairman to appoint a sixth industry member (e.g. from the licensed exempt community). All elected and appointed members must act impartially. All may vote except the chairman who has a casting vote in the event of a tie although the Transmission Company member may not vote in relation to any Modification Proposal.
- a limited liability company (BSCCo or Elexon), wholly owned by National Grid but not a 'controlled' subsidiary, which is funded by all BSC participants. It carries out the functions associated with management and operation of the electricity trading arrangements.

1.7. The BSC Panel has the key oversight role in the administration of the BSC rules. It may perform a number of its functions directly, or may delegate some of these functions to sub-committees of the Panel. In practice, the day-to-day management of the Code will be undertaken by Elexon.

1.8. The adoption of this structure for BSC administration aims to meet the wishes of, and provide comfort to, market participants that there is sufficient transparency, scrutiny and cost control of day-to-day BSC activities on their behalf.

#### ***BSCCo as a code administrator***

1.9. BSCCo (or Elexon) is a wholly owned subsidiary of National Grid, although not controlled by it. This approach establishes effective legal and practical independence for Elexon from NG and allows Elexon to maintain an arm's length relationship with NG. It avoids a potential conflict of interest were National Grid to undertake both the role of system operator under the new arrangements and also undertake to deliver, manage and develop the trading arrangements on an ongoing basis.

1.10. Elexon's objectives (stated in the BSC), funding (provided by BSC market participants) and governance (the appointment of directors) are prescribed explicitly within the BSC. BSC signatories and interested parties would need to raise a code modification to amend it. Elexon and the BSC Panel share the same objectives and Elexon is explicitly obliged to operate as a not-for-profit organisation.

1.11. The BSCCo Board (all non-executive directors) consists of the BSCCo chairman (who is also the BSC Panel chairman), two of the elected industry Panel members (appointed with the agreement of the BSC Panel) and two other directors appointed by the chairman. None of the Elexon management team, including the Chief Executive, sits on the Board, although the latter has a right to attend meetings. The board structure was developed to provide executive oversight of Elexon's activities as prescribed in the BSC.

1.12. Elexon has a remit to manage the BSC in an integrated way. It acts as the contractual agent for BSC parties with the third parties which provide the BSC central systems and process services. It is also responsible for the modifications process. Any system and process changes which are parallel to, or consequent upon, BSC changes are managed by Elexon. Elexon can act as a principal, as well as agent, where explicitly provided for in the BSC. It can enter into accession agreements with new BSC parties and take enforcement proceedings against a Party in default of its Code obligations if instructed by the Panel to do so or the BSC otherwise allows. There are explicit restrictions on Elexon's powers, especially with regard to finances (e.g. as a not-for-profit organisation, it cannot borrow funds over £10m without express permission).

1.13. In addition to the various day-to-day BSC management activities undertaken by Elexon, it is also obliged to carry out periodic reviews of the BSC at least once every two years and prepare reports and other information for interested parties. These obligations aim to demonstrate the transparency of the Code processes to BSC participants.

#### **Connection and Use of System Code (CUSC)**

1.14. The CUSC is the legal contractual framework which sets out the principal rights and obligations of all parties who wish to connect to, or make use of, Great Britain's high voltage transmission network. National Grid, as code owner, is required by its transmission licence to produce the CUSC and to maintain and update it with any change made through the CUSC amendments process. The CUSC was adopted almost wholesale under NETA from the Master Connection and Use of System Agreement (MCUSA) which was the corresponding legal framework used since the privatisation of the electricity transmission network in 1990.

1.15. The CUSC amendments process is overseen by the CUSC Amendments Panel, consisting of a non-voting chairman appointed by National Grid (but who must act independently), seven members elected by users (who must act impartially), two members appointed by National Grid and one consumer representative (appointed by the statutory consumer watchdog) (all other members have a vote). There is no Board structure as exists under the BSC and no independent CUSC Panel members.

1.16. National Grid provides administrative support to the Panel by receiving amendment proposals on behalf of the Panel from parties eligible to raise an amendment. It hosts the working groups which assess amendment proposals. The Panel will ask either a Panel member or National Grid to chair working group meetings. National Grid also prepares the consultation documents issued for consideration by interested parties and the final amendment reports issued to the Authority for decision.

1.17. National Grid will identify and implement any system or process changes which arise out of proposed CUSC amendments and which impact on National Grid while the impact on users is discovered through working group assessment. This is similar to Elexon's integrated role of administering the central change processes. All papers

relating to CUSC amendment proposals are hosted on a dedicated section of National Grid's website.

1.18. National Grid funds the CUSC amendments process through its transmission price control. The costs are incorporated into National Grid's System Operator internal incentive scheme and recovered through Balancing Services Use of System (BSUoS) charges.

### **Uniform Network Code (UNC)**

1.19. Gas transporters are responsible for the development of the rules, systems and processes which relate to their individual gas networks through their licences. Until the sale of four regional gas distribution networks by National Grid (as National Grid Transco) in June 2005, National Grid solely owned the gas transmission grid and all of the major gas distribution networks. The governance model that underpinned National Grid's relationship with network users provided that National Grid have in place a Network Code setting out the contractual terms of that relationship. Network users acceded to the Network Code through framework agreements with National Grid. The modification process was overseen by a Modification Panel and National Grid provided administrative support by receiving modification proposals from parties eligible to raise a proposal. It hosted and chaired the working groups which assessed modification proposals. National Grid also prepared the consultation documents issued for consideration by interested parties and the final modification reports issued to the Authority for decision.

1.20. In consenting to the sale of four distribution networks to other gas distribution network operators (GDNs), the Authority approved a National Grid proposed Network Code modification which provided that National Grid and the GDNs would each develop their own 'short form' network code. Network users would accede to these codes through framework agreements with the relevant transporter.

1.21. Licence conditions also required National Grid and the GDNs to jointly develop and administer a Uniform Network Code (UNC) to be incorporated, by reference, into each transporter's 'short form' code. This would allow future modification of the transportation arrangements and modification rules applicable to all gas transporters under the UNC and the individual network codes. The obligation to develop this revised commercial framework would sit within the licences of National Grid and the GDNs. The gas transporters' licences require them to develop and accede to a Joint Governance Arrangements Agreement (JGAA). A key driver behind the obligation is that governance arrangements should provide a code administrator that is independent of any individual network owner and so avoid discrimination between network owners.

1.22. Gas governance arrangements are split by function and activity:

- the UNC Modification Panel comprises ten voting members (five appointed by the gas transporters and five appointed by gas shippers, who are elected through a process run by the Gas Forum). The modification rules also provide for non-voting members who, other than voting, are able to play a full part in Panel

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meetings. Two consumer representatives are provided for on this basis, as well as Ofgem, terminal operator and small supplier representatives. The non-voting Chairman and Secretary of the UNC Panel are appointed by the Transporters in accordance with the terms of the JGAA. There are no UNC Panel members from outside the industry

- the Joint Office was created to support the UNC modifications process in May 2005 in accordance with the JGAA. The Joint Office is jointly managed and funded by National Grid (as gas transmission and distribution network owner) and the other GDNs but is an unincorporated entity. To preserve its independence, all Joint Office staff are required to act independently and the transporters must undertake not to seek to influence the day to day activities undertaken by Joint Office staff. It provides administrative services to all gas market participants and interested parties. It publishes and maintains details of the progress of UNC modification proposals and more general gas industry information on its website. It hosts and supports meetings relating to UNC modification proposals and more general gas industry issues – the UNC Modification Panel, a number of workstreams and Review and Development work groups which the Panel establishes to deal with specific proposals. It also has responsibility for writing the final modification reports that are submitted to the Authority once the UNC Modification Panel has made its recommendation on whether or not a proposal should be implemented
- a separate agency, jointly owned by all the gas transporters, called xoserve was created in May 2005 to provide a ‘one-stop shop’ solution for delivering transactional services required by gas market participants through appropriate IT systems and processes. The role of xoserve, stipulated in an Agency Services Agreement, is to provide certain core services, paid for by all users through allowed revenue in the gas transmission and distribution price controls, and some additional bespoke services paid for on a ‘user pays’ basis. The core services comprise:
  - change management – systems and process solutions required as a consequence of UNC modifications and industry reform for example
  - commercial analysis – operational and statistical analysis
  - consumer service – answering queries and providing information to gas shippers and to gas consumers directly about their gas supply points
  - demand estimation – a gas supply and demand forecasting service which is used by National Grid in its role as system balancer
  - energy recording, invoicing and balancing – billing all gas users for their transportation volumes and usage

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- o information systems – management of IT systems which underpin xoserve's activities
- o supply point administration – management of information about all gas supply points, specifically which gas shippers are responsible for gas supply at each connected premises
- o knowledge sharing workshops, end-to-end data management services, consumer process improvement support and system testing support which are provided as additional services for gas market participants, current and future

### **Objectives of code administration**

1.23. The BSC Panel has its own objectives prescribed in the Code. Elexon's Code objectives are similar to those of the Panel. The Panel (and Elexon) is expected to apply these objectives in conducting its business – modification-related or not – except to the extent that application of the objective on transparency and openness in the conduct of its business would substantially prejudice the interests of all BSC Parties or a class of Parties.

1.24. The UNC Panel has no separate stated objectives and is not required to consider modification proposals in terms of whether they meet the Code Relevant Objectives in gas transporters' licences. When making a recommendation with respect to implementation of a proposal, the reasons for the recommendation must be given. The gas transporters are expected to provide modification processes that meet certain criteria, as set out in the gas transporters' licence, including the giving of adequate publicity to proposals and consideration of the views of any parties affected by proposals.

1.25. The CUSC Panel does have explicit objectives, namely:

- to operate in an efficient, economical and expeditious manner, taking account of the complexity, importance and urgency of particular proposals; and
- to operate with a view to ensuring that the CUSC facilitates achievement of the Applicable CUSC Objectives.

## Appendix 3 – Initial Impact Assessment

### Summary

This Appendix provides an initial assessment of the potential impact of the various options for changing the role, governance and funding of code administrators and introducing initiatives to facilitate the involvement of small participants, new entrants and consumer representatives with the codes.

### Question box

**Question 1:** Do you agree with our assessment of the various options for reform against the Review Objectives?

**Question 2:** Do you agree with our qualitative and quantitative assessment of the benefits and costs of the reforms?

**Question 3:** Do you agree with our assessments of the impact of reform on consumers, competition and sustainable development?

**Question 4:** Do you agree with our assessment of the unintended risks and consequences?

### Background

1.1. The potential changes to the responsibilities, governance and funding of code administrators described in this document are essentially a menu of possible options and do not form a single set of proposals. They also need to be considered in the context of the proposals for changing in the way in which modification proposals are processed including the possible new routes of major policy reviews and self-governance. For all of these reasons, it is not possible to produce a single impact assessment.

1.2. We have sought to make a provisional assessment of the various proposals on the basis of their potential to make the operation of the industry codes more efficient and more inclusive, taking account of the Industry Codes Governance Review Objectives. However, assigning a quantitative benefit to such outcomes is generally extremely difficult and so most of the discussion that follows is focused on qualitative assessments.

### Role of code administrator in code modifications

1.3. One set of potential changes discussed in this document relates to giving the code administrator more responsibility for the quality of the analysis carried out in assessing modifications, via either a “critical friend” or “active secretariat” option. This, in turn, should help to provide **rigorous and high quality analysis** of the case for and against code changes which is one of the main Review Objectives.

Better analysis by the industry should enable industry participants and the Panel to reach a more informed view of the advantages and disadvantages of modifications. This will be particularly important if some modifications are handled via a self-governance process. In addition, it should reduce the amount of additional analysis that Ofgem has to carry out when a modification comes to us for a decision and should also reduce the risk of Ofgem having to reject modifications that are submitted to it with deficient or inadequate analysis. We consider this would in turn reduce the potential for modification proposals to be re-raised and hence would provide **cost and efficiency** benefits. Moreover, improved analysis should also enable swifter decision making by Ofgem. This should in turn enable modifications that deliver benefits to be implemented more promptly with consequential benefits for consumers.

1.4. Of the two options put forward, it is clear that the “active secretariat” would have more significant implications for code administrators than the “critical friend” option. Our initial view is that the “active secretariat” role might require each of the major code administrators to hire 1.5-2.0 additional FTE economists. If the ‘critical friend’ approach were adopted instead, then our initial view is that the costs would be approximately half those associated with the “active secretariat” option.

1.5. As noted above, there should also be some offsetting reductions in the resources that Ofgem has to devote to code modifications. We estimate that this might be of the order of 2 FTEs across all three major commercial codes.

1.6. On this basis we have estimated in the table below that the net costs of enhancing the role of code administrators in relation to modifications could be £125-200k/yr for the “active secretariat” option and £63k-100k/year for the “critical friend” option.

		Min	Max
<b>Code administrator costs for UNC, BSC, CUSC</b>			
FTE equivalents required	Active administrator	4.5	6
	Critical friend	2.25	3
FTE costs (£/yr)		50,000	50,000
Annual costs (£k/yr)	Active administrator	225	300
	Critical friend	112.5	150
<b>Ofgem savings</b>			
FTE equivalents required	Active administrator	2	
	Critical friend	1	
FTE costs (£/yr)		50,000	
Annual costs (£k/yr)	Active administrator	100	
	Critical friend	50	
<b>Net costs</b>			
Active administrator		125	200
Critical friend		62.5	100



1.7. We would welcome views on this analysis.

## Systems role

1.8. We have discussed the possibility that the JO should be given responsibility for managing the systems related to the UNC. Currently, xoserve runs the UNC related systems under a service contract with NG and the GDNs. The benefits associated with such a change relate to **enhanced analysis** of modifications. In particular, bringing JO and xoserve's responsibilities together might help to enhance the analysis of code modifications by ensuring that cost and systems information is more accessible to the code administrator.

1.9. In the first instance, the costs associated with running the systems should not change simply because responsibility for their management changes. However, there are likely to be significant start-up costs associated with bringing code administration and systems responsibilities together for the UNC.

1.10. Whilst there might be some benefits in terms of enhancing analysis, there may equally be independence concerns associated with combining the code administration functions under the UNC with systems responsibilities.

1.11. Similar arguments and issues also apply for CUSC and BSC were the governance review to consider splitting responsibilities for code administration and systems management into two separate entities. On the one hand this might lead to deficiencies in analysis, however on the other hand it might improve the independence of the administrator.

1.12. It is also not clear to us that a merger of responsibilities in the case of the UNC (or a de-merger of administration and systems responsibilities in the case of CUSC and BSC) would meet the Review Objective of delivering changes in a manner that results in a **proportionate regulatory burden** and **being cost effective**.

## Introduction of independent code administrators or independent panel chairmen

1.13. At present, the JO is only partially independent from the relevant network owners and there is no separation of the CUSC administrator from its network owner. We have outlined options for management unbundling, and for the introduction of completely independent code administrators.

1.14. Our rationale for considering completely independent code administrators (through the creation of board/company structures) is that they would ensure that these codes were **administered in an independent, transparent and objective manner**. Even the lesser step of management unbundling for the CUSC should

improve the independence of its code administrator. It could also be argued that independent code administrators would be more likely to **promote inclusive, accessible and effective consultation**.

1.15. The costs of introducing independent code administrators would, in part, depend on whether their role was changed at the same time (see earlier discussions). Without a change in their role, it is not clear that there would be significant costs because there should be little need to expand the size of the code administration staff. However, there would be costs associated with creating company structures and governance frameworks.

1.16. We are also consulting on the proposal for independent chairmen of code administrators to be appointed by the Authority. Independent chairmen could also be introduced even if no other changes were made to the corporate governance structures. Code or licence modifications (and potentially modifications to the Joint Governance Arrangements Agreement in the case of the UNC) would have to be raised to change the current governance structures but these would be one-off costs associated with simple modifications. We expect that the costs of making these changes would be small.

1.17. New chairmen would have to be appointed by Ofgem and there would be some costs associated with this process. In principle, there should not be any net on-going costs because the costs of the new chairman are likely to be similar to the costs of the existing chairman, although this will, in part, depend on the role of the code administrator.

## Changing the funding arrangements

1.18. We are also consulting on whether there should be changes to the funding arrangements of code administrators for CUSC, and UNC on the assumption that a company was to take on the responsibility for administering these codes. Similarly, we have asked whether improvements could be made to the funding/governance arrangements of the BSC.

1.19. The reason for considering such changes was to provide additional incentives for codes to be **administered in an independent and objective manner** and to improve their **cost effectiveness and quality of service**.

1.20. At this stage we have not evaluated the costs and benefits of different approaches (pass through, price control, service contracts) for the UNC, CUSC and BSC as we have not developed specific proposals in this area. In particular the development of proposals in this area will be dependent on respondents' views including whether there is support for adopting company structures for the administration of the UNC and CUSC as well as the nature of any comments that are received on the governance of Elexon under the BSC. A broad discussion of the advantages and disadvantages of the approaches is set out in Chapter 4.

### “Call in” and “send back” options

1.21. Under these proposals, as discussed in Chapter 5, Ofgem would be able to “call in” and “send back” modifications. In terms of costs, we do not consider that there should be any material costs associated with the “call in” and “send back” options. Indeed, we consider that the existence of these powers should help to incentivise industry and the code administrators to improve the quality and timeliness of their assessments, and as discussed in Chapter 5, should reduce the likelihood that a proposal is rejected by Ofgem (on the basis of deficient or inadequate analysis) and then re-raised. In summary, we consider that these options should help to ensure **rigorous and high quality analysis** as well as increasing **cost effectiveness** within the codes modification process.

### Requiring panels to publish the reasoning behind their recommendations

1.22. We do not consider that there should be any material on-going costs associated with this requirement as it would simply be a matter of the code administrator collecting and recording the panel members’ reasons for decision. In terms of benefits we consider that this proposal should help to ensure **rigorous and high quality analysis** by providing some discipline on panel members to explain their reasoning. We also consider that a requirement to publish reasons would enhance **transparency**.

1.23. There may be some costs in terms of amending codes and licences to introduce this requirement.

### Allowing code administrators directly to raise modifications

1.24. Allowing code administrators directly to raise changes would enhance the **flexibility of the modification arrangements** as administrators would be able to address deficiencies that they have identified and which might not otherwise be addressed by code signatories. Administrators would also be able to identify deficiencies which are acting against the interests of consumers and seek to correct them when they might otherwise not be addressed. Such a change might therefore provide benefits to consumers.

1.25. It is likely that modifications to codes or licences (or the JGA in the case of the UNC) would be necessary to implement this change.

### Introduction of a code of practice

1.26. A code of practice should enable all code administrators to be aware of, and adopt, best practice in the various roles they fulfil. Consequently, this should provide benefits in terms of more **transparent and easily understood processes** as well

as promoting **inclusive and accessible** consultation processes, particularly for consumer representatives and small market participants.

1.27. There would, however, be both set up costs and on-going costs in managing the code of practice (and in enforcing the code of practice to the extent it was binding), since any such code should be viewed as a living document, being updated as circumstances change. Set up costs would be incurred by code administrators as well as industry participants and Ofgem in contributing to the content of the code of practice.

### Performance evaluation measures

1.28. The benefits of introducing performance evaluation measures should be similar to those associated with introducing a code of practice since their purpose is to improve the way in which the various code administrators work. In other words, there should be benefits in terms of more **transparent and easily understood processes** and the **promotion of inclusive, accessible and effective consultation**. A key reason for considering the introduction of performance evaluation measures is that they should increase incentives on the code administrators to ensure that they act in an **independent and objective manner**. They should also promote the **provision of high quality analysis** of change proposals as well as **cost efficiencies**.

1.29. In Chapter 5, we outlined one possible approach to introducing performance evaluation measures: producing a “scorecard” for each code administrator around once every two years. With 10 codes we expect the costs to Ofgem of undertaking such a performance evaluation every two years might be approximately around £70,000.

### Small participant, new entrant and consumer initiatives

1.30. All of the initiatives that we have discussed are intended to **promote inclusive, accessible and effective consultation** for small participants, new entrants and consumer representatives and to ensure that all interested parties are able fully to understand the code governance processes.

1.31. In addition the promotion of effective representation of the views of small participants, new entrants and consumer representatives could, if effectively implemented, improve policy making at the codes level and the assessment of code modification proposals with indirect benefits to consumers and/or competition.

1.32. In the section below we consider some of the costs of the options we set out in Chapter 6. As set out below, the most costly option would be the creation of an Advocacy Panel, although conversely this might provide the greatest level of benefits given the resources that could be devoted to assisting consumer representatives and small participants under this approach.

**Option 1: Status quo “plus”**

1.33. We outlined three initiatives that could be pursued under this option. The first was to ensure that Consumer Focus could have a voting member on the panel of each of the codes. The second was for small participants to have designated representation on code panels. The third was for code administrators to have obligations to engage with small participants, new entrants and consumer representatives at the same time as, but outside of, the modification group process.

1.34. The costs associated with the Consumer Focus panel membership option would relate primarily to higher staffing requirements at Consumer Focus associated with funding UNC panel participation (alongside CUSC and BSC). We anticipate that this would take up a proportion of a senior manager’s role at cost of, say, £20k/year.

1.35. The costs associated with having a designated small market participant representative on the BSC, UNC and CUSC Panels could require 1-2 FTE (each at approximately £50k/year) in total to cover Panel meetings and responsibilities across each of the three major codes.

1.36. If code administrators were to be obliged to engage with small participants, new entrants and consumer representatives (e.g. through a form of reasonable endeavours obligation) through the modification group process, then it is likely that additional code administration staff would be required for this task. As an initial assessment, we assume that around 1 FTE would be required per code. If this requirement applied to the three major codes, then we anticipate the costs should be around £150k/yr.

**Option 2: Advocacy Panel Funding**

1.37. Under the advocacy panel approach there would be two distinct sets of costs. First, the relatively modest costs of setting up and running the advocacy panel. In the Australian example, the administrative costs for 2006/7 (the costs of the panel and its staff – meeting costs, expenses, salaries) were around £80k.

1.38. We have also developed our own estimate of the possible costs of operating the advocacy panel which is set out in the table below.

<b>Advocacy Panel</b>	
Number of members	4
FTE equivalent salaries (£k/yr)	100,000
<b>Time per member spent administering fund</b>	
Meetings (days)	6
Preparation for meetings/analysis of proposals	18
Total	108
FTE equivalence	0.46
<b>Cost (£k/yr)</b>	<b>183,830</b>

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1.39. It should be noted that if Consumer Focus were to be given primary responsibility for the administering the advocacy panel funds, then it is possible that the administrative costs could be reduced, as least as regards set-up costs.

1.40. The second distinct set of costs relates to the funds that the advocacy panel could disburse. In Australia, these costs have varied between just under £500k/yr to nearly £1000k/yr depending on the volume of successful applications. These costs would seem to provide a reasonable benchmark of the level of funding that might be required in order to make the advocacy panel effective.

### ***Option 3: Consumer Challenge Group***

1.41. Ofgem currently pays the expenses of participants in the Consumer Challenge Group consisting of consultancy day rates and travel expenses. Our proposal would allow a dedicated group of individuals to meet on a regular basis to consider codes issues and act on opportunities to act as advocates for the consumer interest. These individuals would be paid by Ofgem to act on this basis.

### ***Option 4: Code administrator advocacy and assistance obligation and duty***

1.42. We envisage that the costs for code administrators of complying with a general duty to assist small participants, new entrants and consumer representatives would be similar to those associated with the more specific obligations set out in Option 1 above.

## **Impact on Consumers**

1.43. We have assessed above, in general terms, the benefit and cost implications of the various options that we have set out in this document, having particular regard to the Review Objectives.

1.44. The key benefits to consumers associated with the options set out above are in two categories, namely:

- **The benefits to those consumers and consumer groups who engage directly in the modification process.** We have set these out above already, and they include transparency, accessibility, and inclusivity benefits. We also believe that to the extent that self governance is introduced, there are important benefits to consumers associated with being able to engage in and understand the modifications that are being considered through the industry code processes.
- **The benefits to consumers generally.** We consider that by helping small market participants and new entrants to engage in the codes process this should indirectly facilitate competition. In particular the changes set out in this document should help smaller participants, new entrants and consumer representatives engage in, understand and influence the codes modification process. Ultimately, making the regulatory framework more transparent and accessible should benefit competition. In addition, there is also the possibility

that the changes that have been proposed should help small participants, new entrants and consumer representatives raise code modification proposals that provide benefits to consumers. Further, by improving the quality of analysis that is undertaken and the efficiencies of the code modification process, this should also indirectly ensure that modification decisions that benefit consumers are made faster than is currently the case.

1.45. It is important to note that many of the proposals would incur costs that would ultimately be borne by consumers. In some cases these costs are likely to be minimal, but in other cases, such as the creation of more active code administrators or advocacy panels the costs are likely to be greater.

1.46. We would welcome views from respondents on which proposals they believe are proportionate to the costs involved.

### **Impact on Competition**

1.47. As we have discussed above in the section on consumer impacts, we consider that the improvements in the governance process that help facilitate engagement from small market participants and new entrants in the codes modification process. We consider that increased transparency in the code change process should help facilitate understanding of the regulatory arrangements. Many small participants and new entrants have limited resources compared to the larger incumbent energy businesses and therefore struggle to engage in reform in key policy areas. By helping small participants and new entrants to engage this should indirectly help to generate pro-competitive policy proposals, with consequential benefits to policy making and potentially benefits to competition.

### **Impact on Sustainable Development**

1.48. It is important to note that many of the smaller participants that struggle to engage in existing codes processes due to their complexity and resource intensive and piecemeal nature are smaller generators, often from the renewable sector (including distributed generation). This has been particularly the case with the Transmission Access Review process where smaller generators have found it difficult to engage in the code modification and policy development process.

1.49. We consider that the introduction of policies to improve engagement and participation from small parties and new entrants such as renewable generators might provide consequential benefits in terms of policy development in the sustainable development area.

### **Impact on Health and Safety**

1.50. We do not foresee any impacts on Sustainable Development or Health and Safety as a result of these proposals.

## Risks and Unintended Consequences

1.51. We consider that the key risk is that the changes proposed do not deliver their intended benefits and that consumer representative/small participant engagement does not increase as a result of any changes that are implemented.

1.52. A particular risk is that the roles and responsibilities of code administrators are expanded with minimal consequential benefits and, with industry participants incurring more costs in funding these responsibilities. For example, it is possible that new objectives and roles are created for code administrators to act as a “critical friend” or that a more “active secretariat” is created without the consequential improvements to analysis being achieved.



## Appendix 4 – Consumer advocacy funding in Australia

1.1. The National Electricity Consumers Advocacy Panel was established in 2001 to grant funds to representatives of domestic and business electricity consumers to support their advocacy activities regarding the development of the National Electricity Market (NEM) and the National Electricity Rules (NER). The Panel was established under the National Electricity Code. Its (independent) chairperson was appointed by the National Electricity Code Administrator (NECA). In 2008, the Panel was reconstituted as the Consumer Advocacy Panel with responsibility for the granting of funds for advocacy and research on electricity and natural gas issues.

### Reasons for, and establishment of, the Panel

1.2. NECA commissioned a report in 2000 which concluded that domestic customers, small and medium-sized businesses, and commercial customers do not generally have access to sufficient human and financial resources to ensure a proper voice in the NEM decision-making processes. NECA therefore recommended that market-based funding should be provided through a levy on generators and retailers (the National Generators' Forum and the National Retailers' Forum).

1.3. The Advocacy Panel originally consisted of equal numbers of representatives from customers and market participants with a NECA-appointed independent chair. The Panel would determine the total resources to be made available, and establish criteria and funding guidelines, for customer advocacy. It would allocate funding to individual projects in accordance with the criteria and guidelines based on applications made to it. The Panel could also commission its own research and make this accessible to all interested customers.

1.4. The Panel now consists of a chairperson and four members appointed by the federal Energy Minister on the recommendation of the Ministerial Council on Energy (MCE). Vacancies for Panel members are advertised. Panel members are selected based on:

- their knowledge of the energy sector;
- their ability to assess funding applications against specified criteria;
- their experience in public interest advocacy; and
- their ability to assess proposals for energy sector research that would benefit consumers of electricity or natural gas.

1.5. Panel members are appointed for 4 years (there are rules for removal from office, resignation, etc). The Panel obtains administrative support from an Executive Director, appointed after agreement between the Panel and the AEMC, and sufficient other staff members as necessary to ensure the effective performance of the Panel. The Panel meets monthly.

## Panel functions and funding

1.6. The Panel must act independently and has two objectives:

- to have regard to any relevant objectives set out in a National Energy Law; and
- to seek to promote the interests of all consumers of electricity or natural gas while paying particular regard to benefiting small to medium consumers of electricity or natural gas.

1.7. In seeking to meet those objectives, the Panel carries out the following main functions:

- identifying areas of research that would be of benefit to consumers of electricity or natural gas (or both);
- developing, and submitting for MCE approval, guidelines for the allocation of grants for consumer advocacy projects and research projects for the benefit of consumers of electricity or natural gas (or both);
- preparing, and submitting for MCE approval, annual budgets for the allocation of grants for consumer advocacy projects and research projects, etc;
- determining (subject to the approved guidelines and budget) how grants for consumer advocacy projects and research projects, etc. are to be allocated;
- preparing, and submitting for MCE approval, guidelines to assist applicants seeking grants for consumer advocacy projects and research projects, etc.; and
- publishing on its website and in other appropriate ways the results of its own research and other research of interest to consumers of electricity or natural gas (or both).

1.8. The Panel prepares and submits a budget regarding its own administrative spend alongside the budget for funding advocacy grants, split between gas and electricity. The proposed budgets are consulted on with stakeholders prior to MCE approval. The Panel's own spend must be incurred as efficiently as possible to maximise funding for projects.

1.9. Funding for the grant allocation comes from two sources – the AEMC for projects related to gas consumers and the National Electricity Market Management Company (NEMMCO) (the Australian system operator) for projects related to electricity consumers, or jointly where projects relate to both sets of consumers. The Panel is neither a company nor a statutory body. Its annual report details its activities and financial records.

## How the Panel carries out its functions

1.10. The Panel's website provides more details about its activities and how applicants may apply for and obtain grants. There are specific guidelines for grant applications. The key criteria for grant allocation (to be approved as regulations by the MCE) are that:

- funding must be for a diversity of projects which meet the Panel's objectives and take into account:
  - the number and range of consumers who may benefit from the relevant projects; and
  - the nature of the interest represented across the projects; and
  - the issues to which the projects will relate
- a project which intends to benefit electricity consumers should:
  - relate to the development, design or operation of, or policies associated with, the NEM or the supply of electricity, or other issues covered by the National Electricity Law or the National Electricity Rules; or
  - directly relate to an aspect of the responsibilities of the AER, the AEMC or NEMMCO under the National Electricity Law or the National Electricity Rules; or
  - have some other relevance to the NEM or the supply of electricity, when viewed as a whole.
- a project which intends to benefit gas consumers should —
  - relate to the development or operation of gas pipelines, or policies associated with obtaining access to gas pipelines, or relate to other issues covered by the National Gas Law or the National Gas Rules; or
  - directly relate to an aspect of the responsibilities of the AER or the AEMC under the National Gas Law or the National Gas Rules, or the responsibilities of the Economic Regulation Authority under that law or those rules in Western Australia; or
  - have some other relevance to the national gas market or the retailing of gas, when viewed as a whole.

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- o a funding application must relate to an issue that is relevant to a material number of consumers
- o there is an expectation (but not a strict requirement) that a successful applicant for funding will part-fund the costs of the project (either by the applicant gaining access to other sources of funds, or by the applicant contributing to the project by providing staff, facilities or other resources)
- an applicant for funding must furnish a project plan that includes:
  - o an outline of the objectives of the project;
  - o information identifying whether the project is intended to be for the benefit of consumers of electricity, consumers of natural gas, or consumers of both; and
  - o a proposed budget; and
  - o the amount of funding sought from the Panel.

1.11. A successful applicant will sign an agreement with the AEMC providing details of the funding which the Panel will provide, the project timescales and the requirement to provide a report to the Panel on the outcomes of the project within two months of completion. The successful applicant also needs to keep relevant records relating to the project which it should provide to the Panel on request, stating what project outcomes were achieved and how much it cost to achieve them.

1.12. The Panel will oversee post-project reviews undertaken by an external body for a sample of funded projects to assess whether they achieved their objectives and how effectively and efficiently the funding provided was spent.

**Typical recent projects**

1.13. A range of state and national consumer groups and representatives have applied for funding since the start of the scheme. In the last published Annual Report (2006/07), it was noted that there were 50 funding applications compared with 77 for the previous year. 33 grants were made.

<b>Applications Approved: year to 30 June 2007</b>	<b>Business</b>	<b>Domestic</b>	<b>Total</b>
Funding up to AU\$50,000	20	8	28

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Funding AU\$50,000 to AU\$100,000	1	2	3
Funding >AU\$100,000		2	2
Total approved applications	21	12	33

1.14. The following table provides a breakdown of the issues that these projects covered and the percentage of the costs that the advocacy panel funded.

<b>Issue</b>	<b>No's of projects</b>	<b>Funding (AU\$)</b>	<b>Funding as % total cost</b>
Attendance at forums	2	14,860	1.4%
Advocacy/capacity building	8	539,103	49.3%
Distribution	2	41,920	3.8%
Generation	1	25,968	2.4%
Retail	3	66,485	6.1%
Transmission	5	137,384	12.6%
Wholesale market design	12	266,911	24.4%

1.15. The table highlights that the range of applicants is diverse as are the types of project funded. The funded amounts also vary. The Energy Users Association of Australia is quite active in seeking funds as are Major Energy Users Inc (both business sector). However, the domestic sector also provides considerable numbers of applicants.

1.16. The funding budget provided to the Panel since its inception has been as follows:

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<b>Year</b>	<b>Budget in £ (£1=AU\$2.4)</b>
2002/03	458k
2003/04	458k
2004/05	504k
2005/06	642k
2006/07	802k
2007/08	815k

1.17. Recently, the Panel has consulted on changes to the grant funding application criteria. It also commissioned an external consultant to consider whether there were gaps or overlaps in the types of consumer groups seeking funding so that the process could work more effectively in targeting funds at a more varied group of potential applicants. The gap analysis has highlighted that certain groups, e.g. green consumers, are less well catered for in terms of their accessibility to funding for advocacy projects.

## Appendix 5 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority’s powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002, the Energy Act 2004 and the Energy Act 2008, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.<sup>9</sup>

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly<sup>10</sup>.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity inter-connectors.

1.5. The Authority must when carrying out those functions have regard to:

- The need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- The need to secure that all reasonable demands for electricity are met;
- The need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>11</sup>; and
- The interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.<sup>12</sup>

<sup>9</sup> entitled “Gas Supply” and “Electricity Supply” respectively.

<sup>10</sup> However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

<sup>11</sup> under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

<sup>12</sup> The Authority may have regard to other descriptions of consumers.

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1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- Promote efficiency and economy on the part of those licensed<sup>13</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- Protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity;
- To contribute to the achievement of sustainable development; and
- Secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- The effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- The principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- Certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>14</sup> and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

1.9. The Energy Act 2008 contains provisions which, once commenced, will modify the general duties of the Authority in carrying out its functions under the Gas Act and the Electricity Act. In particular, those changes will mean that, when carrying out its functions in the manner which it considers is best calculated to further its principal objective, the Authority must do so by having regard to the need to contribute to the achievement of sustainable development equally with the need to have regard to the need to secure that all reasonable demands for electricity and gas are met and that licensees are able to finance their regulated activities.

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<sup>13</sup> or persons authorised by exemptions to carry on any activity.

<sup>14</sup> Council Regulation (EC) 1/2003



Code Governance Review – Role of code administrators and small participant/consumer initiatives

December 2008

1.10. It has also been highlighted within the text of the principal objective that the Authority's consideration of the interests of consumers includes both future as well as existing consumers.

1.11. The Energy Act 2008 received Royal Assent on 26 November 2008 but these provisions do not have legal force until they are commenced. We do not yet have a commencement date for the new provisions but it is likely to be early in 2009.

1.12. During the period between the Energy Act 2008 having received Royal Assent and commencement of the provisions which affect its duties, the Authority must continue to apply the principal objective and its statutory duties in accordance with the Gas Act and the Electricity Act as they currently stand (i.e. prior to the Energy Act 2008 amendments taking effect), although it will be mindful of the changes that are forthcoming. The Authority already takes account of sustainable development in its decisions but with the change in duties the weight that is attached to such considerations will be increased.

## Appendix 6 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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