

Consumer Focus Submission

Ofgem Industry Code Governance Reviews:

- 1. Major Policy Reviews and Self Governance**
- 2. Role of Code Administrators and Small Participant and Consumer Initiatives**

February 2009

Executive Summary

- Consumer Focus welcomes the review of industry code governance, including the role of code administrators, small participants and consumer representatives.
- There is a real need for improvements to the industry code arrangements so that consumers benefit from reforms quicker and that the process is more inclusive of all those involved in the market.
- It is important that consumers' voices are heard in this process as technical changes to the codes may change the way the market operates in terms of pass through costs, distortion of competition and/or restricting new players.
- Based on our experience we believe that there have been significant delays in dealing with change proposals in key strategic areas. This has also meant in some cases that benefits to consumers have been delayed or not delivered.
- Generally, we support the key proposals outlined in the Ofgem consultation papers, including the three path approach for dealing with code modifications. However we believe further work, safeguards and appeal mechanisms will be required.
- Consumer Focus seeks full membership and voting rights on the BSC, CUSC, DCUSA and UNC. We also would like to maintain a watching brief over the other code panels with the right to raise issues or modifications if and when necessary.
- We do not support the proposal that Consumer Focus administer an advocacy fund.

Consumer Focus Response to Key Issues

Major Policy Reviews and Proposed 'Three Paths'

1. Consumer Focus agree that there is a real need for reform of the industry codes governance arrangements. There are significant challenges facing the gas and electricity markets in Great Britain, such as security of supply and sustainable development. We believe changes to the industry code governance arrangements are important to help ensure that the market can meet these challenges.
2. We also agree that the current arrangements are unnecessarily complex and have made it difficult for small and new participants in the market and consumer representatives to understand and engage in the process.
3. Consumer Focus has been concerned about the difficulties facing small and new participants in the market generally. In our response to the Ofgem probe we acknowledge the importance of a competitive market and that barriers to entry do exist. We would like to see less complex and easy to understand arrangements as these would benefit all

participants in the market. Therefore we support reforms to the industry code arrangements because in the long term we believe this will contribute towards a more competitive market.

4. There will be real advantages in adopting the proposed three path approach for dealing with modification proposals, provided they do result in reform and not merely the introduction of further bureaucracy and 'red tape'. The idea for separating out the way in which modification proposals are managed via a major policy review, an improved status quo process or a self governance process is a good one. As these Ofgem consultation papers acknowledge code panels do differ in their arrangements and methods of operation. We consider that once the new governance arrangements are agreed this new approach should be applied to all relevant/appropriate codes. This does have implications, initially at least, for resourcing and require the agreement of industry parties involved, however, we believe that in the long term this will ensure the efficient and transparent operation of code panels and the code modification process.

Major Policy Reviews

5. The issues of electricity cash out and transmission access are two examples of recent major policy issues where delays and difficulties experience have led consumers missing out on real benefits. A major policy review used in these instances could have resulted in a quicker process and a more efficient use of Ofgem, industry and stakeholders resources.
6. Overall while we support the proposal for major policy reviews we would require that adequate safeguards and appeals mechanisms are set up prior to the introduction of any new arrangements. This is discussed further below. We are also concerned that rather than taking on the role as sole decision maker without industry involvement, Ofgem, as regulator, needs to maintain independence and distance from the process wherever possible.
7. There are a number of issues currently facing the industry that may require a major policy review, for example smart meters. It would be useful if Ofgem in partnership with the code panels analyse the possible major policy review topics that may arise over the next three to five years. This will facilitate a planned and strategic approach to major policy reviews. It must also be acknowledged that these reviews will take time and resources not only for Ofgem but also for industry, therefore careful planning is important. We note that only one or two reviews should be undertaken annually as they will be fairly resource intensive. Ofgem should also highlight any planned major policy reviews in their corporate strategy.

8. By using a planned and strategic approach to major policy review, we believe that this will enable Ofgem and industry to anticipate issues before they arise and set about integrating solutions to issues and pre-emptively preventing consumer detriment.
9. It is unclear from the consultation documents how a major policy review, once commenced, would proceed. If the standard Ofgem style of consultation was used, we would have concerns. Generally speaking, Ofgem tends to put out consultation documents, wait for responses and then proceed on the basis of submissions received. We would like to see Ofgem use more innovative styles of consultation. Ofgem could think about smarter ways to engage with industry and stakeholders. Examples include roundtable discussions linked to consultations, 'teach-ins', more accessible consultation documents and meeting directly with stakeholders.

Improved Status Quo

10. Ofgem outline a number of strategies to improve the status quo and propose that modifications with a 'likely' impact on consumers and/or competition would be assessed using this improved process. Based on the definitions of 'likely' and 'significant' impact provided in the consultation document (refer to 3.15), we believe it would be difficult to assess the 'path' a modification should follow. We believe further information on the definition and differences between these terms, is required.

Self Governance

11. Consumer Focus anticipate that we would have little or no involvement in modifications 'travelling' along the self governance path, given that this 'path' is meant to cover minor housekeeping matters.
12. We believe that the processes involved in the self governance approach will need to be carefully considered prior to establishment. There is a risk that some modifications that are initially thought to have minimal or no impact on consumers may, upon review, be more suitable to be addressed by path two, improved status quo. The process for this needs to be clear and transparent.
13. In summary, in relation to the proposed three path approach, Ofgem's consultation papers do not provide enough detail on three issues:
 - a. How the major policy reviews will operate;
 - b. The definition of the terms used to determine which path is followed (significant, likely and minimal impact on consumers or competition); and

- c. The need for further information about the prioritisation of Ofgem initiated and industry proposed major policy reviews.
14. We would like to see further work and consultation on these three issues prior to the introduction of any new arrangements.

Safeguards and Appeal Mechanisms

15. Ofgem has outlined a number of more specific proposals for safeguards and appeal mechanisms, our specific response on these follow below.

Filtering Criteria and Process

16. It is important that industry and panels have a voice in this process and so we support the proposal whereby panels allocates proposals to a path (two or three) with Ofgem holding right of veto. We do not support the proposal that Ofgem decide which path the proposals should follow, as this would involve micro-management by Ofgem.
17. When a decision is made about which path is to be followed it would be useful if an explanation or rationale for its decision is provided by the panel. Ofgem should also provide this information when it decides to initiate a major policy review.
18. It seems sensible to have a moratorium on modifications that fall within the scope of a major policy review, however it is important that there is scope that the issues raised in the modification are considered as part of the review.

Outcomes of Major Policy Reviews

19. With regard to dealing with the outcomes of the major policy reviews, we believe that the involvement of the panel is crucial to ensure that the modification is suitable and appropriate and will achieve the recommendations of the review. We therefore support option one where high level binding conclusions are provided to the panel by Ofgem who then develop the modification.
20. The panel and industry would be involved and consulted in the review process and therefore they should be able to adequately reflect the policy conclusions in the modification proposal/s.
21. If however, the subsequent modification proposal does not adequately deal with the policy conclusions, Ofgem could reject the modification and then the issue would default to option three, where Ofgem prepare the modification proposal and legal text. However, this should be used as a last resort, because as previously stated we would prefer to see Ofgem maintain independence and distance from the process, wherever possible.

Moratoriums and Appeals Mechanism Following a Major Policy Review

22. We agree that existing appeals process is sufficient. The current system of appeals ultimately to the Competition Commission is an adequate means to appeal decisions if required.
23. Ofgem seek views on moratorium on modifications in areas where a review has been conducted. We support a moratorium for a short period of time such as two years. This would allow time for the modification changes to embed and take effect. There does need to be opportunities for further changes in order to deal with matters that may change over time such as issues associated with climate change or security of supply. Therefore we do not support a total moratorium, discretionary powers by Ofgem or a complete Ofgem veto.

Self Governance Path - Voting and Appeals

24. Given that path three modifications will be dealing with matters considered housekeeping or with little or no impact on consumers Consumer Focus would have no involvement in consideration of those modifications. We would however need to be monitor decisions about whether the modification follows path two or three and where a path three modification needs to be redirected to path two. It is therefore important for us to maintain a monitoring role over the self governance path.
25. We do support the view that the commercial panels include consumer representation and whenever possible a small market participant. This matter is also covered by the review into code administrators and we provide our detailed views on this at paragraphs 30-51.
26. We believe the voting arrangements for the self governance (and improved status quo) path should reflect those currently used by the BSC, an independent approach. While there are some advantages to the representative model, the independent voting model leads to more principle based decisions and consumers voices can adequately represented in this model. We believe that it would be beneficial if this voting model applied to the commercial panels in all circumstances and not just applied when dealing with modifications in the self governance path. We also support decisions made by a simple majority in the commercial codes. However it may be appropriate for signatory voting on the technical codes (such as SPAA, UNC and MRA).
27. The key issue for us is that consumers voices are represented and can be expressed and considered fairly.

Redirection

28. It seems logical to us that if a modification proposal needs ‘redirection’ that Ofgem has the right to redirect. However we believe that any panel member, including the consumer representative also has the right to request Ofgem redirect the proposal. Justification or sound argument would need to be provided by any party seeking a redirection, including Ofgem.

Appeals Process during Path Three

29. We support the need for an appeal mechanism during path three given the role of the panel as decision maker and the fact that Ofgem will have little or no involvement in this process. We also acknowledge that the exact nature of the appeal process may depend on the final voting structures; however, we support the proposed option that grounds for an appeal is based on the decision having a disproportionate impact on a class of signatories. Consumer Focus would maintain a watching brief on modifications being considered in this path and if necessary may make an appeal if the impact on consumers is considered to be disproportionate. Although if this was the case then we believe that the matter should have been redirected to path two earlier in the process.
30. If this appeal mechanism is adopted then we believe that a general right of appeal for consumers is not required or necessary. If an appeal was made, it should be to Ofgem in the first instance.

Impact Assessment

31. The impact assessment and case studies make a strong case for the package of reforms being proposed. We note the assessment of potential cost savings of the proposed reforms and acknowledge the resourcing implications for industry should the proposals be adopted. We believe that in the long term the reforms will benefit both the industry and consumers.

Role of Code Administrators and Small Players and Consumer Representatives

32. The current code administration arrangements are overly complex and disadvantage small participants and consumer representatives from full participation. Ofgem is proposing a range of options to improve these arrangements which in general Consumer Focus supports.

Role of Code Administrators

33. The quality of analysis in code modification reports should be of the standard required to properly assess the impact of the modification proposal. It is our view that it is the role of the both panel and the code administrator to ensure that the quality of the report is of a high enough standard to properly analyse the impact of the modification.
34. We believe that improvements to the governance structures for code administrators and panel are needed. These improvements range from changes to structures, funding and role of code administrators to formalising arrangements to ensure active participation of small participants and consumer representatives.

Critical Friend or Active Secretariat

35. Ofgem have outlined proposals to expand the code administrator's role to take a more active role in processing modification proposals in order to improve the quality of analysis and of decisions. Ofgem propose that code administrators become either critical friends (some, if not all code administrators would say that they already perform this role) where they challenge and question the panel modification proposals or they take on an active secretariat role whereby they can raise proposals and take a lead role in assessing the modification.
36. Both options would be an improvement on the current system, however both have staffing and resource implications. It is assumed that the critical friend approach would not require the level of resourcing as the secretariat role. Consumer Focus supports the formalisation of the arrangements to ensure code administrators at the very least take on the critical friend role. In addition the code administrator needs to take on the role of specifically providing information and advice to consumer representatives and small market participants, flagging up issues of special interest to consumers or code panel members. This should naturally flow from the justification of selection of the modification path.
37. Consideration should be given to the idea that the critical friend approach is adopted while the active secretariat role is phased in over several years. This would allow industry to adequately resource the active secretariat role and set up the required structures.

Governance and Funding Arrangements

38. Ofgem have proposed that code administrators could be responsible for both code systems and administration. We believe the advantages of this joint role (such as effective functioning) outweigh the perceived disadvantages (such as conflict of interest). Given the

complexities involved in changing the current arrangements where some code administrators have the joint role of administrator and systems operator and some do not, a thorough analysis of the implications and consultation with stakeholders would be required prior to adoption of this proposal.

39. Ofgem also seek views on whether the panels should have uniform governance via an independent company and board or via integration between code administrator and network owner and on funding options of code administrators.
40. We support a uniform approach to governance arrangements if possible. Our experience with the commercial codes leads us to support the use of an independent company and board, similar to the BSC and Elexon role but we support an independent chair for panels. We believe that this approach would be a appropriate especially if the administration and systems operation role were combined.
41. We believe that for efficient functioning code administrators should have defined and clear objectives governing its performance for costs and quality of service. All code administrators should have, if they do not already, measurable performance targets.
42. While there are advantages and disadvantages for each of the proposed three funding options. Cost pass through or service contracts would appear to be the more suitable options, as they would be clear, transparent and accountable. Of the two, we believe a service contract approach would provide incentives for the code administrator to maintain efficient costs. We do not support inclusion of costs in price control mechanisms as it would not be cost efficient to separately price control code administrators.
43. We agree that merging code administrators would be a substantial and resource intensive exercise, unless a merger is voluntarily agreed by those parties involved. If this were to occur it would be an ideal time to ensure any new governance arrangements are adopted/incorporated.
44. Consumer Focus supports the suggested five improvements:
 - That Ofgem can call-in and send-back modifications;
 - Require all code panels to provide reasons for their recommendations;
 - Enabling code administrators to raise code modifications;
 - Introduce a code of practice for all code administrators; and
 - Creating performance evaluation measures for code administrators.
45. While these improvements could be implemented quickly, to be effective they do need to be included as part of the package of reforms.
46. It should be noted however, that enabling code administrators to raise code modifications goes beyond the role of critical friend, however we believe that these proposals would be beneficial and an improvement on current processes.

47. We note that the Code Administrators Working Group (CAWG) has been reviewing a number of issues being addressed in the Ofgem consultation documents. It is important that the two reviews do not duplicate effort and the CAWG report once finalised is reviewed alongside the consultation responses for these reviews.

Small Participants, New Entrants and Consumer Representatives

48. As previously stated, we believe that small participants, new entrants and consumer representatives face hurdles engaging in the process to differing degrees, depending on the technical expertise and resources available to participate on a number of panels. We also believe that because changes to the codes can change the way the market operates in terms of significant pass through costs to consumers, distortion of competition and/or restricting new entrants into the market, that consumers' voices need to be heard in this process.

Consumer Representation on Panels

49. Consumer Focus does not currently have the right to attend or vote on all panels. Rather than supporting a proposal that we are represented on all panels, we would prefer to target our resources and efforts, so that consumers are represented on panels where changes have the most significant impact. We propose that Consumer Focus have full membership and voting rights on the following panels: BSC, CUSC, DCUSA and UNC. We would like to maintain a watching brief on the other code panels and have the right to raise issues or modifications if and when necessary.
50. Full participation on these selected code panels gives us greater scope to advocate and voting sends a clear signal to industry about our position and when a proposal will have a negative impact for consumers.
51. We believe our proposal will benefit the modification process as Consumer Focus can input effectively, monitor any changes to codes and if necessary raise awareness of the impact upon consumers.

Advocacy Panel

52. Ofgem suggests the establishment of an advocacy panel funded by industry, based on an Australian model, where financial assistance is provided to advocacy groups representing those who would not otherwise be able to engage in the code change process. A sub option also proposed by Ofgem is that Consumer Focus could administer this fund.

53. The advocacy panel approach has some advantages in enabling small and new players and consumer groups increase their engagement and influence in the market. We would agree that this is an important issue to address. However, some groups may already be sufficiently resourced to be able to engage in the code modification process and thus funding be directed to parties not in need of it. The burden of applying for funding on the very small party could also prove to be as onerous as participating in an unsupported manner.
54. There are two alternative options, that a small fund be established, administrated by Ofgem, that funds the collective representation of smaller groups and new market participants. This fund should have minimal processes involved for accessing funds as additional 'red tape' will be a disincentive to apply for funding. The fund should seek to cover the interests of particular groups (e.g. small suppliers) rather than individual companies. A second option is that code administrators provide advice and support to enable small participants effectively engage with the process, as part of their formal role as a critical friend. We support the second option.
55. The idea that Consumer Focus administers the fund has serious resource implications for us. Consumer Focus does not support the proposal.