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Mark Feather  
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27 February 2009

Dear Mark,

## **Code Governance Review – role of code administrators and small participant/consumer initiatives**

The Joint Office of Gas Transporters (JO) welcomes the opportunity to comment on Ofgem's Consultation Paper *Code Governance Review: role of code administrators and small participant/consumer initiatives*. The views in this response are those of the JO and, for the avoidance of doubt, I can confirm that Gas Transporters have not sought to influence or approve this response. Views on the specific questions raised in the Consultation paper are included as an appendix to this letter. The views expressed necessarily focus on experience with the gas Uniform Network Code (UNC) – we have no direct experience of other codes on which to draw.

In order to meet new Licence conditions associated with the sale of distribution networks, the JO was established by the Gas Transporters at the inception of the UNC. It was accepted during discussions surrounding the network sales process that it would be inappropriate for a single transporter to be responsible for code administration. The intention behind the JO's constitution was therefore to ensure that no transporter could exert undue influence over the JO and consequently over the code administration process, and that the JO should be required to act independently and without discrimination. This requirement for independent operation is supported by the UNC Modification Rules, which define the UNC modification processes and require both transparency and consistency, with the Modification Panel, as opposed to the code administrator or one or more transporter, exercising oversight of a range of code governance issues.

While acknowledging that there is scope for improvement in the governance process, we believe that this model has worked effectively for the gas industry as a whole, with the JO being recognised as an independent and impartial code

administrator. Our view is that steps to improve governance processes should, at least in the case of the UNC, focus on the Modification Rules rather than the nature and role of the code administrator. In particular, we would urge caution before any move which would reduce the independence of the code administrator, such as the possibility of making all code administrators responsible for central systems. While we would not want to rule out the possibility of close working relationships between the systems provider and code administrator, and can see some practical benefits from this in our own circumstances, we would not support a formal requirement to merge the roles.

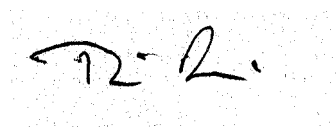
Consistent with our support for an independent and impartial code administrator, we do not support the concept of code administrators providing an active secretariat role. We consider the critical friend role is consistent with independence and impartiality – asking questions and recording views put forward rather than seeking to interpret and evaluate those views. Similarly we do not believe that it would be consistent with independence and impartiality if the JO were to be responsible for the commissioning and direction of analysis. While it would be possible for the modification rules to provide for additional analysis to be commissioned, we believe it would be appropriate for this to be controlled by modification panels and for any costs to be passed through to all industry players. The JO could provide administrative support for this approach, were it to be adopted, but responsibility and accountability should reside with modification panels.

Until questions regarding the role and scope of the code administrators are determined, it seems inappropriate to definitively address questions regarding the appropriate management and funding arrangements for any code administrator. At the time of network sales, it was concluded that it would be disproportionate to establish the JO as a separate limited company. By contrast, if the JO were to become responsible for systems, similar to the existing Elexon structure, a more formal governance structure would seem entirely appropriate.

Similarly, if the JO is to retain much the same obligations as at present, there is no strong case for changing either the funding or operational arrangements. That said, we can envisage that the industry may value the code administrators being regarded as industry resources with their impartiality and independence protected through additional or different mechanisms. We would welcome, therefore, an assessment of an alternative model under which modification panels would have a greater influence over code administrators' internal arrangements, including setting an appropriate budget which would be passed through to all industry participants.

We hope these comments are helpful and, as always, would be happy to discuss or elaborate on any of the points raised.

Yours sincerely,



Tim Davis

Chief Executive

## **Code Governance Review: role of code administrators and small participant/consumer initiatives**

### Appendix: JO Response to Questions Raised

#### **Chapter 2**

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

If the Authority and Ofgem do not believe they are receiving the information needed to take decisions, then this is a very real concern that needs to be addressed. But this is not straightforward and particularly difficult since, when assessing change proposals, the analysis often involves anticipating behavioural responses – analysis is more than mechanical fact reporting. In reality, organisations may not understand how they will actually behave differently until they have learned from experience following implementation of a change.

In order to improve the quality of analysis provided, we would suggest that, in the first instance, consideration should be given to which parties are best able to provide appropriate analysis. For example, if an assessment of IS costs as a result of implementation is required, those responsible for implementation (be they network owners or shippers/suppliers) are best placed to provide cost estimates. In terms of the code relevant objectives, when looking for analysis as to how a change proposal might impact system operation, it seems entirely appropriate to address the question to the system operator. By contrast, if looking at the relevant objective regarding furthering competition, it is clear that neither a network owner nor code administrator should be expected to be experts in this area and so to be able to provide insights. It may also be the case that incumbent suppliers are unwilling to reveal information regarding competition impacts since this could be commercially deleterious. Our view given this is that it would seem more appropriate to look to Ofgem – consistent with its statutory duties - to provide robust analysis on competition impacts.

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

The JO believes that accountability in terms of applying modification rules and acting impartially is more important than accountability in terms of budget and reporting. On this basis, it is hard to see that some code administrators are more accountable than others.

In trying to compare accountability, the JO is fully accountable to the gas networks for budget and performance, and being focussed primarily on code administration means that this is very direct and real accountability. While our understanding is that Elexon is clearly accountable to its Board, we believe that this is primarily on the basis of systems provision rather than specifically as a code administrator and hence it could be argued that the code administration role is less accountable than that of the JO. We similarly presume that those supporting administration of the CUSC are fully accountable for their own performance within National Grid. Arguably, a contracted service provider model is the least accountable in the sense that any such provider is only answerable to those that let the contract, and only accountable for what is specified in the contract rather than general performance and perceptions.

**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?*

We believe code complexity is far more of an issue than code governance and management of the change process. This could be addressed by a far reaching Major Policy Review which looks at the need for the degree of complexity which is now embedded within the gas and electricity industry. For example, complex processes are in place which seek to accurately allocate energy among players, and there may be merit in considering whether the costs of these processes justify the benefits or if there may be a beneficial trade-off between cost and accuracy. Any such review might also usefully look at the number of codes and whether having several smaller codes is more or less simple than having one larger one which encompasses most aspects of the regime. Consideration could also be given to terminology

and requirements in the gas and electricity markets with a view to increasing consistency and so facilitating cross market understanding.

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

This is a question for the parties concerned.

## Chapter 3

**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?*

We accept that there is scope for the quality of analysis in code modification reports to be improved but do not believe this should be addressed through a change in the role of the code administrators.

**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?*

The JO supports the critical friend approach, and believes this is the approach which it already takes. There is no obvious reason why the code administrator role should be different between codes.

Rather than the Code Administrator becoming an active secretariat, we believe there is a case for an active code owner – the body that knows and understand the code in detail. That role is already seen in practice, with our understanding being that Elexon (as systems operator rather than code administrator) tends to perform this role for the BSC, as does National Grid for the CUSC and Grid Code (and Gas Transmission).

**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?*

We believe that to deliver independent and impartial code governance there are advantages in having code administrators that do not have potentially conflicting responsibilities, such as a result of being responsible for central systems management. Hence the JO's view is that code administrators should not be responsible for systems. However, we also believe that it is important to consider the specific circumstances of each code in this respect and to look particularly at code coverage. The BSC and Elexon are reasonably aligned, such that it may be sensible for code administration and systems to be provided by the same organisation. By way of contrast, the UNC and xoserve are not aligned – the UNC goes beyond xoserve in terms of systems since it also covers Transporter systems.

## Chapter 4

**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?*

We believe that there are advantages if the code administrator is independent of any interested party and not just a network owner. However, it is important to consider scale and hence the practicality of governance arrangements. The JO currently has six staff to deliver its UNC modification process requirements and other responsibilities on behalf of the networks. Being a separate limited company with all the associated requirements is simply not justified for a pure code administrator on this scale. We also believe that there are advantages from building flexibility into the arrangements such that, for example, the code administrator can undertake roles where and when doing so is supported by other parties. For example, the industry has welcomed JO support for Substitution Workshops and User Pays groups but these may not be permitted under a formal corporate structure with tightly defined Articles based on acting solely as a code administrator.

Our view is that management unbundling is sufficient provided there are appropriate safeguards and obligations which help to secure an impartial and independent code administrator. We believe that the JO arrangements, including the associated GT Licence obligations and the Joint Governance Arrangements Agreement (a copy of which is available from our website), provide a proven model which has supported the provision of an independent and impartial code administrator.

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

The governance structure for each code should reflect the circumstances and requirements of the code concerned rather than necessarily being a one-size fits all approach.

**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?*

The JO believes that the focus of accountability should be on outputs not inputs. Modification rules are key in this respect since they specify the outputs which must be delivered and the process to be followed by code administrators. The administrators are very accountable in all of this activity since it is highly transparent and visible, and modification panels play a particular role in holding administrators accountable if performance is below that required. If the industry is not satisfied with delivery, we would expect to see modification proposals being raised which seek to refine the modification rules – we have not seen such proposals in recent years in the UNC context.

**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?*

We do not believe any of the suggested arrangements are the most transparent and accountable. Cost pass through is arguably the most transparent but least accountable; price controls are arguably the least transparent but most accountable. The transparency of service contracts varies, and accountability may be focussed on the contract terms, which is not always appropriate.

**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?*

We do not know of any evidence which would suggest that the effort and cost involved in establishing this approach is likely to be outweighed by any advantages. Indeed, we fear there could be disadvantages such that any such imposition would be inefficient and uneconomic especially if it constrained flexibility. It is also worth noting that the option of adopting a service contract approach is already available to those accountable for the costs and, if they thought it worthwhile, they would have adopted this route.

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

We do not believe this is necessary but accept that funding should be reconsidered in light of the model which is adopted for each code administrator.

## Chapter 5

**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?*

We believe these powers could be extremely valuable in a limited range of circumstances but would expect them to be used sparingly. In the majority of cases, active Ofgem involvement in industry debates and working groups, including early warnings should ensure that recourse to formal powers should be very much the exception rather than the rule.

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

The UNC Panel minutes already record a general view of the Panel debate prior to a vote being taken, focussed on the relevant objectives expected to be impacted by a Proposal.

While these views have not been ascribed to particular members, final votes are recorded and entirely transparent. It is not clear what benefit there is under the status quo path for publishing additional information beyond this, although we believe that there would be benefit in establishing best practice among the code administrators which most closely meets customer needs.

For self governance purposes, it will be important to develop a process in which all industry parties are confident, including the way in which decisions are made and recorded. This therefore needs to be considered as part of a wider package of detailed proposals for the way in which self governance should be implemented across all codes, including the question as to whether a panel is the appropriate decision taking mechanism.

**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?*

No – this would be inconsistent with independent and impartial administration.

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

There would be potential benefit in codifying best practice, such as the way in which panel recommendations are recorded in minutes. We do not believe a code of practice could be binding since there is a risk that the modification rules in any code could be modified such that the governance process ceased to be consistent with the code of practice.

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

The JO would be happy to cooperate with any measures to produce a scorecard and to be judged by measures which others believe capture the value of the service provided. For us, customer satisfaction is central and would suggest there could be merit in a central customer satisfaction survey being undertaken on a periodic basis, covering all code administrators and demonstrating the extent to which they were meeting their customers' expectations.

*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.*

Day to day users of the codes are generally better placed than the code administrators to identify these areas.

## Chapter 6

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

This is primarily a matter for small parties, but we believe that all parties, irrespective of size, find it difficult to engage until familiar with the concepts and terminology. Consistency, such as through a code of practice, could help those involved with more than one code. We appreciate that entering the energy market involves considerable investment to understand the market, but believe that code governance is a small part of this.

**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?*

This is a matter for the parties concerned to address.

**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?*

We would urge caution regarding any mechanism which mimics or could be seen to undermine the commercial provision of advice. The market can and does provide services and these are necessarily tailored to what clients require. A central solution provided by code administrators might damage private provision and so destroy a valuable resource and source of advice, which is better for being heterogeneous - crowding out on the back of regulated income should be avoided.

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

This is a matter for the parties concerned to address.

**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?*

This is a matter for the parties concerned to address.

*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).*

The UNC Modification Rules provide for Panel representatives from the iGTs, small suppliers and terminal operators in addition to consumer representatives. These are, however, non-voting representatives and participation in practice has been limited. It is also worth noting that among the five shipper voting members at present, only two are from the so-called "Big 6" energy suppliers and others, as such, might be categorised as small participants, albeit that "small" is not necessarily a good description of the parent company involved.

## **Impact Assessment**

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

We are not clear why enhancing the role of code administrators would necessarily improve the quality of analysis.

We agree that independent code administrators meet the Review Objectives but do not accept that this is an issue only in the case of UNC and the CUSC – the BSC code administrator is certainly not independent but rather is part of Elexon.

We do not believe that Panel Chairs being appointed by Ofgem is necessary to deliver independence or would make a significant difference to the current position.

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

We do not believe there would be any additional costs for the JO if the critical friend approach is recommended. The costs of providing an active secretariat would vary depending on the level of activity envisaged.

An independent, Ofgem appointed, Panel Chair would be expected to increase code administration costs to the extent that this would be a part time role that could not be offset by only partly reducing an existing role.

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

It is not clear that making all code administrators responsible for central systems would necessarily improve the analysis of modifications – which is not generally related to the costs of systems implementation. We believe it is extremely unclear 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.

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

An additional risk is that some of the possible changes might encourage a less independent and objective code administrator, instead creating a body with its own agenda that it seeks to promote and develop.