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Dear Colleague

**Open letter consultation: Code Administration Code of Practice
Ofgem Ref: 45/10**

We have today published our Final Proposals for the Code Governance Review, with an accompanying document setting out our proposed licence modifications to give effect to the Final Proposals. The Code Administration Code of Practice (CoP) forms an integral part of these proposals. We propose that the industry code modification processes are aligned and made consistent with the principles set out in the CoP.

The purpose of this letter is to consult on the draft CoP which we are minded to approve, subject to a number of amendments. While the CoP has been developed primarily with the UNC, BSC and CUSC in mind, we consider that the principles contained within it can appropriately be adopted by other industry codes - to the extent they represent recognised best practices which are also appropriate for those codes.

One intention of the CoP is to provide guidance to parties on the process involved in progressing proposals to modify industry codes. Another is to establish principles of best practice and standardisation regarding both the Code Administrator (CA) role and code administration more generally. It should help align CA processes and enable similar processes to be followed where appropriate. The CoP also clarifies what kind of assistance parties can reasonably expect from the CAs.

Background

In June 2008 we published our decision on the scope of the Review of Industry Code Governance, one aspect of which was to reduce any unnecessary complexity and fragmentation of the existing codes governance. Such complexity is an obstacle for all market participants, but presents a particular barrier to new entrants and smaller parties seeking to engage in codes processes. We consider that removing barriers to participation for these parties is likely to promote competition and should stimulate innovation within the codes regulatory framework. We therefore invited industry participants to explore the potential for simplification and convergence of code modification processes in order to reduce complexity and encourage best practice across the codes.

This led to the creation of the Code Administrators' Working Group (CAWG), which looked at improvements which could be made to the code modification processes without structural change, for instance through modification to the existing rules or simply changing custom and practice. It was anticipated that the work of this group, focussing primarily on 'bottom up' reforms, would be complementary to the Role of Code Administrators work

strand, which looked at the 'top down' reforms that, including those that might require changes to licence conditions and/or funding arrangements¹.

The Code Administrators' Working Group (CAWG) Interim Report

The CAWG provided Ofgem with its interim report in early 2009. This report contained sixteen recommendations, which we subsequently consulted upon in our open letter of 20 April 2009². Whilst respondents were free to comment on any aspect of the report, we invited comments particularly on those recommendations which we considered may have a bearing on our Initial Proposals, as follows:

Ownership – the CAWG recommended that the proposer of a modification retains ownership and effective control over the content of the proposal. It felt that this would improve enfranchisement and encourage greater participation in the modifications process;

Alternatives – the CAWG considered that more consistent arrangements around the timing and number of permitted alternative modification proposals should provide opportunity for further options to be considered, while ensuring that each is robust, fully assessed and subject to scrutiny;

Legal text – it was noted that each of the codes currently has a different approach to the production of legal text, particularly with respect to timing. The CAWG saw value in the legal text being consulted upon earlier in the process, while retaining flexibility to amend it in light of comments and/or developments. The group also felt that the Code Administrator should be empowered and funded to procure legal advice and text directly;

Code of Practice – it was recommended that the Code Administrators be subject to a Code of Practice, setting out the principles to which modification rules should adhere. It was considered that these principles should represent best practice and make best use of any lessons learnt. The CAWG considered that the Code of Practice should also provide for standardised templates and require the use of common terminology and plain English; and

Critical Friend – following on from proposals in our earlier CGR consultations, the CAWG recommended a requirement for Code Administrators to act as a 'critical friend'.

Whilst the CAWG recommendations represented the views of that group, its suggestions for the Code of Practice and the Critical Friend approach were consistent with the proposals set out in our CGR Initial Proposals, and subsequently influenced the thinking on our Final Proposals.

We considered that it would be appropriate for the other recommendations of the CAWG including those on ownership and the production of legal text to be addressed through modifications to the industry codes and/or inclusion in the CoP principles rather than a specific modification to licence. We note that BSC proposal P247 'Proposer ownership of modification proposals' has recently been raised to address the first of these but do not comment further on this development.

Role and Status of the Code of Practice

Following our CGR Initial Proposals, the CAs of the BSC, CUSC and UNC together produced a draft CoP. This document builds upon the principles agreed by the CAWG, setting out a standard process that the BSC, CUSC and UNC modification rules should follow, generally simplifying the process. Code participants would otherwise have to familiarise themselves with differing sets of rules and procedures. To facilitate this, the CAs have also produced a set of standard templates. The CoP also sets out the practical measures that the CAs will

¹ For further details see: Code Governance Review – Final Proposals

² See: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=41&refer=Licensing/IndCodes/CGR/CAWG>

be expected to undertake in discharging their obligations to act as a critical friend and provide assistance to parties.

The CAWG was reconvened in November 2009 in order to consider the draft CoP and templates. The group subsequently endorsed the document and recommended that it be subjected to a wider industry consultation.

As set out in our Final Proposals, while we remain of the view that the CoP represents a useful guide to industry generally, we also consider that there should be a clear requirement on the CAs to adhere to the high level principles set out in the CoP, as may be amended from time to time. The CoP will be an evolving document and may be amended by the users of the CoP from time to time, subject to approval by the Authority, as set out in the draft licence conditions published today.

Suggested amendments to the CoP

We welcome the development of the CoP and are supportive of the principles it contains. However, subject to responses and other developments prior to it being finalised, we consider the following changes to the CoP would be appropriate:

- clarification of the ownership and change control of the CoP, as at Principle 4;
- an amendment to Principle 7 regarding alternative proposals; and
- the addition of Principle 12, covering key performance indicators (KPIs).

The CoP is set out in Annex 1 of this letter with our proposed changes being marked.

Change control

As the CoP will be referred to in licence with a requirement that the CAs have regard to it, we agree with the CAs that Ofgem should have a role in its ongoing change control. We also agree that that a group such as the CAWG may play a useful role in developing future versions of the CoP, prior to wider consultation. However, we do not consider that it would be appropriate for Ofgem to retain an ongoing role in editing, or providing drafting for the CoP. This would more appropriately be a matter for the CAs themselves.

Alternative proposals and timetables

The CAWG interim report notes that problems exist with the current arrangements for alternative proposals. In the case of the BSC, the rule that there can be only a single alternative proposal was considered overly restrictive. The problems with the UNC were primarily around timing, in particular the tension between there being sufficient time to ensure any alternative is subject to the same rigour as the original, while not wanting to delay progression of that original. The CAWG considered that there is merit in the recently modified CUSC arrangements, whereby all alternative proposals must be raised during the workgroup process. We consider that this view should be reflected in Principle 7.

We also note that under the BSC and the CUSC any extension to the development timetable must be agreed with the Authority. This requirement does not exist in the UNC. We consider that the Authority's ability to object to an extension provides a safeguard against undue delay, i.e. where the costs of delaying outweigh the justification. We therefore propose that the UNC is brought into line with CUSC and BSC.

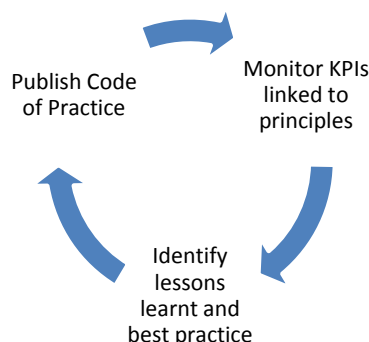
Key Performance Indicators (KPIs)

In our CGR Initial Proposals we indicated that some form of performance 'scorecard' would be the most appropriate way of introducing performance evaluation measures, and suggested that this could be undertaken by Ofgem. We remain of the view that regular benchmarking will improve transparency on the relative performance of the CAs and increase accountability for costs and quality of service. Following consideration of

responses to our initial proposals we now consider that this could be best achieved by including within the CoP a principle that each CA reports on their performance to us and the relevant panel.

We consider that, in order to allow for an assessment of comparable performance, it will be appropriate for each of the BSC, CUSC and UNC CAs to adopt a common set of core KPIs. However, this would not preclude additional, code specific KPIs, being developed at the relevant panel's request or CA's initiative.

Recognising that CoP principle 4 already states that the CoP will be reviewed periodically and subject to amendment by Users, we consider that the KPIs will provide a feedback loop, identifying best practice, prompting it to be adopted elsewhere and acting as a catalyst for future revisions to the Code of Practice, as follows:



We also consider that the effectiveness of the CA in delivering the critical friend role will require a degree of qualitative assessment. For instance, it is not enough to measure how many requests for assistance were received and dealt with in a timely manner, but also how helpful the requesting party considered the CA to be. These elements will require some form of user survey to be carried out, as has been the case in the past. We consider that this could appropriately be carried out by an impartial third party, whose expertise lies in market research. Whilst we would expect the composition of the survey to be largely a matter for the appointed agent, we would expect it to cover the BSC, CUSC and UNC in order to ensure that performance is comparable.

Given the complementary relationship between the KPIs and future revisions to the CoP, we consider it appropriate for them to be embedded within the CoP itself. We have therefore proposed that they be inserted as a new Principle 12. As the CAWG did not develop a set of KPIs for inclusion in the CoP we have set out a 'straw man', together with a rationale for each of the suggested KPIs at Annex 2, though at this stage we have no fixed view on what the KPIs should be.

The templates to accompany the CoP remain under development, though current drafts of the skeleton templates and some examples of how they would appear populated with text from an actual mod can be viewed at: www.gasgovernance.co.uk/cop/templates.

Although the templates also form part of this consultation, it would be helpful if you could direct any comments on them to the Code Administrators directly, via the Joint Office at: enquiries@gasgovernance.co.uk

Questions for respondents

Our Final Proposals for the Code Governance Review place an obligation on the licensee to adhere to the Principles contained within the CoP when establishing and/or applying the modification arrangements as stipulated under licence. We therefore do not consult here on the status of the CoP, but the contents of that document. In particular, we welcome your views on the following:

1. Do you agree with each of the principles listed in the CoP?
2. Is the description of the change process in the CoP sufficiently detailed?
3. Is there anything missing from the CoP that you feel should be covered?
4. Do you agree that the CAs should be required to report on their KPIs?
5. Do you agree that those KPIs should be set out in the CoP?
6. Should the results of the KPI reporting influence future revisions to the CoP?
7. Do you have any comments or suggestions on the proposed KPIs?

Next Steps

Subject to responses to this consultation we propose to publish an approved version of the CoP on the Ofgem website alongside our statutory consultation on the proposed licence modifications. This will allow licensees to have full sight of the implications of the CoP as regards their licence obligations, as modified by the proposed licence drafting. The licensees and Code Administrators will retain responsibility for ensuring the CoP remains fit for purpose, capturing lessons learnt from its practical application and ensuring that their modification rules and procedures allow them to adhere to the principles. We envisage that the result of the KPIs reporting will have a role to play in this, as set out above.

As part of the consultation on this CoP and associated KPIs we propose to convene an open **workshop on 29 April 2010** so that the CoP can be reviewed in detail and also allow for detailed discussions on formulating the final version of the KPIs to be adopted. If you would like to attend please confirm your interest by emailing: industrycodes@ofgem.gov.uk by 12 April 2010.

We request that **responses to this consultation** be sent to Catherine Wheeler at to be received no later than **12 May 2010**.

Yours faithfully,

Mark Cox
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