



Industry participants, customers
and other interested parties

*Promoting choice and value for
all gas and electricity customers*

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Dear Colleague,

Industry Code Governance Review – second phase

I am writing to inform you of our intention to commence a 'second phase' of the Code Governance Review, in order to extend developments made to the Balancing and Settlement Code (BSC), Connection and Use of System Code (CUSC) and Uniform Network Code (UNC) into the remaining industry codes and agreements.

Background

The industry codes are the contractual arrangements that underpin the electricity and gas wholesale and retail markets. They define the terms under which industry participants can access the electricity and gas networks. Ofgem's Code Governance Review (CGR) sought to review the governance arrangements of these codes to ensure that the modification processes and code administration remained fit for purpose.

The final proposals of the CGR¹ were published in March 2010 and led to a number of changes to the BSC, CUSC and UNC code governance arrangements. An overview of the CGR outcomes is below:

Role of Code Administrators – In order to establish common governance principles, a Code Administration Code of Practice (CACoP)² was developed by industry and the BSC, CUSC and UNC were mandated through licence conditions to have regard to its principles. Alongside this a specific licence condition for code administrators to adopt a 'critical friend' role³ was introduced. Other codes have adopted the CACoP principles on a voluntary basis and a review of this document is presently underway by code administrators and users to consider any amendments required following its first year of implementation.

Changes were also implemented to require the BSC, CUSC and UNC panels to explain the reasons for their recommendations in respect of code modifications. 'Send back' powers were introduced to allow the Authority to return final modification reports to the panels where it is considered that sufficient analysis has not been provided such as an insufficient assessment, incorrect legal text or other technical flaws. To date, three final modification reports have been returned by the Authority for further analysis. The CGR brought the BSC, CUSC and UNC into line with each other in regard to the appointment of independent chairs and voting consumer representatives on the panels.

¹ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=297&refer=Licensing/IndCodes/CGR>

² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=328&refer=Licensing/IndCodes/CGR>

³ The 'critical friend' licence condition describes a requirement on the code administrator to provide assistance to parties, on request and insofar as is reasonably practicable, in relation to drafting a modification proposal, understanding the operation of the code, and their involvement in the modification processes amongst other things. Particular reference is made to small participants and consumer representatives.

Significant Code Reviews – A role was defined for Ofgem to lead complex changes to the industry codes with the introduction of Significant Code Reviews (SCRs). We have since launched two SCRs to review Gas Security of Supply and Electricity Transmission Charging (Project TransmiT⁴). We have recently consulted on issuing a third SCR to consider reviewing the electricity cash out arrangements.

Self Governance – Industry self governance was introduced into the BSC, CUSC and UNC, allowing Ofgem to step back from changes to the code arrangements that have minimal consumer impact and to enable industry to take more operational code change decisions. Since the introduction of self governance 32 code modifications have been progressed in these codes via this route. There have been no appeals against the validity of these decisions to date.

Charging Methodologies – The CGR incorporated network charging methodologies into the CUSC and UNC to provide users the opportunity to propose change. Thus far 7 charging proposals have been raised to these methodologies and subject to open governance. Separately, outside of the CGR, relevant charging methodologies have also been incorporated into the Distribution Connection Use of System Agreement (DCUSA).

Environmental assessment – A requirement was introduced to eight of the ten industry codes to ensure that the code panels assess, where appropriate, the impact of modification proposals on green house gas emissions, in addition to other relevant objectives.⁵

Reasons for undertaking a second phase CGR

Whilst the final proposals of the CGR focussed primarily on the three main industry codes, we did not rule out the implementation of these outcomes into other codes. The CGR aimed to ensure more effective and efficient decision-making and to ensure long-term value for industry participants and consumers. We consider that further work could be done to enable the remaining industry codes to benefit from the CGR outcomes.

We recognise that some code changes have already been made or are being considered by code panels in response to the CGR, outside of the BSC, CUSC and UNC. We support these moves to review code processes in line with CGR principles and propose to now work with industry to ensure that optimum outcomes are achieved in delivering consistent and effective governance arrangements.

In particular we consider that increasing industry self governance and further aligning codes to a set of common governance principles would be positive steps forward in reducing unnecessary regulatory burden and reducing code fragmentation. We consider that ease of access to the code arrangements can help to promote effective competition and that alignment and simplification of the governance processes has particular benefit to smaller participants and new entrants. We also recognise that whilst some of the codes already benefit from a degree of self governance, under the current arrangements we are signing off on code modifications that could effectively be dealt with by industry, leading to decreased industry costs and quicker implementation of changes. Furthermore, in order to ensure that complex or cross-code change is achieved most efficiently going forward, we consider that it could be beneficial to incorporate the SCR process into the remaining codes.

Proposed scope and timing

With the new CGR arrangements now in place for over one year, it is timely to look at the implementation of these changes and seek to capture lessons learned and address any issues.

⁴ The scope of Project TransmiT is on the charging arrangements that seek to recover the costs of providing electricity transmission assets, i.e. TNUoS charging.

⁵ The 'environmental assessment' work strand of the CGR applied to all industry codes except for MRA and SPAA. Licence modifications implementing the Code Governance Review can be found at <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=330&refer=Licensing/IndCodes/CGR>

Alongside this we will consider whether some or all of the remaining industry codes should now be captured by the CGR outcomes. We consider all remaining industry codes to be potentially within the scope of this review, namely: Distribution Connection Use of System Agreement (DCUSA), Network Code/Uniform Network Code for Independent Gas Transporters (iGT UNC), Master Registration Agreement (MRA), Supply Point Administration Agreement (SPAA), System Operator Transmission Owner Code (STC), Grid Code and Distribution Code. In particular we will consider:

- The potential for more self governance within the codes;
- The ability for Ofgem to include all applicable codes within an SCR;
- A review of the code administration processes and potential implementation of the Code Administration Code of Practice into other industry codes.

In our CGR final proposals we proposed to undertake a post-implementation review of the introduction of SCRs and self governance after three years. As such a full post-implementation review at this stage is not proposed. However a 'lessons learned' exercise will be an important part of this second phase CGR to address any issues immediately arising from the implementation of the CGR outcomes, prior to such outcomes being implemented into other codes.

We also indicated that a review of open governance of charging methodologies would be undertaken after a sufficient number of modifications had gone through the process. This will be revisited in due course and further work on network charging methodologies governance is not proposed under the scope of this review.

Indicative timetable

The proposed timings outlined below are based on reporting year April 2012-March 2013 and are indicative only at this stage:

Responses to this open letter – 24 May 2012
Development of proposals in discussion with industry parties – Q1
Publish consultation and draft licence modifications – Q2
Publish conclusions and statutory notices – Q3
Issue directions – Q4
Licence modifications take effect – 1 April 2013

Comments

We would welcome your views both on the changes implemented by the Code Governance Review and whether this implementation has thus far been successful, and on the intention to extend the CGR outcomes into other industry codes. Please send responses to this open letter to industrycodes@ofgem.gov.uk by 24 May 2012. In particular:

- Has the requirement on code panels to provide rationale for their recommendations been effective in improving analysis to support code changes?
- Has the concept of 'critical friend' been effectively embraced by the Code Administrators (i.e. an obligation to assist interested parties, particularly smaller participants/new entrants and consumer groups)?
- Do you support the Code Administration Code of Practice being implemented under all industry codes, to aid convergence and transparency in code governance processes?
- Is the self governance criteria introduced by the CGR appropriate and has the implementation of self governance been effectively achieved in BSC, CUSC and UNC?

- Do you consider that introducing or increasing self governance in the codes would be beneficial?
- Has the SCR process met with your expectations thus far, in terms of frequency of SCRs, timings and process?
- Do you consider that Ofgem's guidance in respect of SCRs⁶ has been sufficiently clear and detailed?

Following this open letter we will also contact the relevant code panels directly to further discuss the intentions of the second phase CGR and impacts and issues that may arise as a result of potential CGR changes.

Yours sincerely,

Declan Tomany
Associate Partner Legal - Smarter Grids and Governance

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http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/Guidance_initiating%20and%20conducting%20SCRs_final%20draft_110810.pdf