All interested parties

Email: industrycodes@ofgem.gov.uk
Date: 15 May 2015

Dear Colleague,

Further review of industry code governance

The gas and electricity industry in Great Britain is facing significant change in the coming years. This change includes the:

- roll out of gas and electricity smart meters to over 53 million domestic and non-domestic premises by 2020
- low carbon transition which will lead to increasing levels of intermittent electricity generation and new low carbon technologies, with potentially a greater role for flexibility in the system including demand side response (DSR)
- EU Third Energy Package[1], which is introducing new Regulations, known as European Network Codes (ENCs), governing the design, operation and planning of the European energy sector.

These issues are already driving change to the detailed rules that underpin the operation of the industry and further changes to the rules are needed. These rules are set out in a number of industry codes, which include governance arrangements that define how the codes may be changed.

We have previously reviewed the industry code governance arrangements and introduced reforms to improve them[2]. However, in the context of the anticipated scale of change required in the coming years, we continue to have concerns that the arrangements may not be operating in the best interests of consumers. We consider it is timely to review the reforms we have implemented and potentially introduce further reform to the arrangements.

We set out in this letter our current views on the issues we see with the industry code governance arrangements. We comment on some of the key governance reforms we have already made. We also set out our initial views on potential further improvements in these areas, building on the reforms we have already introduced. It is important to ensure the arrangements are fit-for-purpose for a changing industry, in particular increasing numbers of smaller parties and 'non-traditional' business models, and in light of the increasing pace, volume and complexity of change planned in the coming years.

*We are seeking your views on the issues discussed in this letter by **26 June 2015**.*

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[1] The Third Energy Package of 2009 is a suite of EU legislation for European gas and electricity markets to promote the completion and efficient functioning of the single European energy market. It provides the legal basis and procedures for ENTSO-E and ACER to develop EU network codes.
[2] Through our Code Governance Review (CGR) project which concluded in 2010, and the second phase of CGR which concluded in 2013: https://www.ofgem.gov.uk/licences-codes-and-standards/codes/industry-codes-work/code-governance-review

Industry code governance is one of the areas also being considered by the Competition and Markets Authority (CMA) as part of the ongoing energy Market Investigation Reference (MIR). We have set out in our recent response[3] to the CMA's updated issues statement[4] that we welcome the inclusion of this as a new theory of harm. The potential governance reforms discussed in this letter may go some way to addressing some of the issues the CMA is considering. The CMA may identify further remedies if they conclude this issue is impacting competition in the retail market. We are supporting the CMA by providing them with information and expertise throughout the investigation.

Background

Industry codes

The industry codes are, broadly speaking, the contractual arrangements that underpin the operation of the electricity and gas industry arrangements. Licensees are required to establish, maintain, become party to, and/or comply with the industry codes in accordance with the conditions of their licence. Unlicensed parties may also be party to some of the industry codes. Each of the codes contains detailed rules governing how changes to the codes are made. An overview of the main industry codes for gas and electricity is set out in Annex 2.

Code Governance Review

We launched our Code Governance Review (CGR) in November 2007[5], in light of the evolving nature of the industry and strategic challenges likely to impact the code arrangements. The first phase of CGR concluded in 2010. In our CGR final proposals[6], we identified a number of deficiencies with the arrangements and introduced a range of reforms in two main areas. First, seeking to reduce unnecessary barriers and red tape in the existing industry code governance arrangements. And second, aimed at ensuring that significant code change could be delivered more effectively. We recognised that the code governance arrangements worked well in delivering incremental change to industry codes, but that they had not been effective in supporting larger scale and more complex change. In 2013, we concluded the second phase of CGR (CGR2)[7], extending our key reforms to cover all of the industry codes.

The governance reforms we introduced under CGR and CGR2 include:

- **Significant Code Review (SCR):** this process enables Ofgem to lead a holistic review that may result in complex and/or cross code change. We introduced new powers to enable us to direct a relevant licensee(s) to raise code changes to give effect to our SCR policy conclusions.
- **Role of Code Administrators:** we introduced a number of changes aimed at improving code administration arrangements, including
  - Code Administration Code of Practice (CACoP), aimed at aligning processes across codes and capturing best practice in code administration
  - 'Critical Friend' role for code administrators to support code users, in particular smaller parties, in the modification process.

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[3] https://www.ofgem.gov.uk/ofgem-publications/94288/responsetotheupdatedissuesstatement-pdf
[4] https://assets.digital.cabinet-office.gov.uk/media/54e378a3ed915d0cf7000001/Updated_Issues_Statement.pdf
[5] We issued an open letter announcing our review: https://www.ofgem.gov.uk/ofgem-publications/61488/open-letter-announcing-governance-review.pdf. We commissioned consultants to undertake an independent critique of the code governance arrangements and published their report in June 2008: https://www.ofgem.gov.uk/publications-and-updates/independent-critique-codes-governance-arrangements-commissioned-ofgem-and-prepared-brattle-and-simmons-and-simmons
[6] https://www.ofgem.gov.uk/ofgem-publications/61245/cgrfinalproposals310310.pdf
[7] https://www.ofgem.gov.uk/ofgem-publications/61109/cgr-2-final-proposals.pdf

- **Self governance**: we enabled industry to make decisions on code changes which do not have a material impact on, for example, consumers or competition.
- **Charging methodology governance**: we included certain charging methodologies within industry codes, introducing arrangements to enable code parties and other materially affected parties to propose changes.

Ongoing governance issues

We consider that the reforms we introduced under CGR and CGR2 have improved the code governance arrangements, as we discuss further below and in Annex 1. However, the challenges that we identified when launching our original CGR remain. In addition, feedback from stakeholders and the ongoing difficulties we have seen in the delivery of beneficial change through code modifications suggest the need to review the CGR reforms and consider the case for further reform in this area.

Smaller parties continue to raise concerns around the difficulty they have engaging in the code change processes, and that the arrangements are a barrier to entry. This has been raised by parties responding to our state of the market assessment[8], in the context of the ongoing MIR and in the work DECC are leading on the Supplier Challenge Programme[9]. We have also identified complexity and the rules as a potential barrier to entry in our recent non-traditional business model discussion paper[10].

We have ongoing concerns about the quality of industry analysis on complex change and the risks associated with lack of co-ordination across codes. In addition, we face difficulty driving through change where there may be industry opposition through a lack of incentives for industry to engage in the change process. This can hinder the timely consideration of code modifications, including cross-code issues, and delay the realisation of benefits for consumers[11].

Our concerns are heightened in the context of an evolving industry, in which the volume and pace of change is increasing. There is a need to deliver major reform in the coming years. For example significant changes will be required to fully deliver the benefits of smart meters, as a result of increasing levels of intermittent generation and to implement European Network Codes in GB.

Review of CGR reforms and further potential changes

We therefore think it is timely to give further consideration to the governance issues we looked at under CGR, to review if our reforms achieved their aims and whether any further reform may be appropriate.

We have set out in Annex 1 our views on the effectiveness of some of the key reforms we introduced (and, where relevant, extended to other codes under CGR2). We consider our reforms have improved the code governance arrangements. For example:

- The SCR process has enabled us to lead reviews and propose reforms in a number of areas where we have had longstanding concerns, ie gas security of supply, electricity "cash out" and electricity transmission charging.
- The CACoP and code administrator critical friend role can play an important role in encouraging best practice, consistency across codes, and supporting smaller parties.

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[8] https://www.ofgem.gov.uk/publications-and-updates/state-market-assessment
[9] https://www.gov.uk/government/publications/government-and-ofgem-action-plan-challenger-businesses-independent-energy-suppliers
[10] Please see our recent discussion paper: https://www.ofgem.gov.uk/ofgem-publications/93586/non-traditionalbusinessmodelsdiscussionpaper-pdf
[11] As set out in our February 2014 open letter: https://www.ofgem.gov.uk/ofgem-publications/85909/letteronindustryroleinsupportingdelivertofsmartmeteringbenefits.pdf

- Self governance has been successful in enabling effective and efficient delivery of changes without material consumer or competition impacts, allowing us to focus resource on more material changes.
- Including charging methodologies within the codes has enabled more affected parties to engage directly in proposing, developing and assessing charging reforms.

However, we have ongoing concerns as discussed above. We consider further change may be needed to ensure the arrangements are fit-for-purpose for a changing industry and, as discussed above, the increasing pace, volume and complexity of change planned in the coming years.

We have therefore set out in Annex 1 our initial views on potential areas where further reform may be appropriate, including:

Significant Code Reviews (SCRs):
- we are seeking views on the current SCR process, and whether there are changes that would enhance the process, or whether an alternative process may be appropriate in some cases. For example, to give us the ability to specify timetables and draft code modifications ourselves.

Code Administration
- we would welcome views on how code panels, code administrators and the wider industry could operate in a more proactive and strategic way in their management of the code modification processes. For example by agreeing code change priorities, better coordinating change across codes, addressing concerns regarding incumbency advantage in the change processes, identifying consumer impacts of change, and ensuring panel composition supports a robust decision making and recommendation process.

Self governance
- we are seeking views the effectiveness of the self governance arrangements across the different codes, and whether the self governance criteria remain appropriate.

Charging methodology governance
- following the introduction of open governance for charging methodologies under CGR, we would welcome views on whether the existing governance processes could be adapted to better manage and streamline the assessment of charging modifications. For example through enhanced and more efficiently managed pre-modification processes, more effective 'packaging' of charging proposals, and/or the establishment of a clearer change cycle (eg modification 'windows'/set periods when modification proposals can be raised and assessed together). It may also be appropriate for such a change cycle or change window to apply in areas other than charging.

Views sought

We welcome your view on all of the issues discussed in this letter, and in particular on the following questions:

Question 1: Do you consider the governance changes introduced under CGR and CGR2 have been effective in improving the code governance arrangements. In particular considering the efficiency and effectiveness of code change, the ability for large scale reform to be implemented, and the accessibility of the arrangements for smaller/newer industry participants and consumer representatives?

Question 2: Do you agree that there is a need to consider further reforms to the industry code governance arrangements? If so, what issues do you consider should be addressed, and what possible solutions do you identify?

Question 3: In addition to a post implementation review of our CGR reforms and potential changes discussed in this letter, are there any other areas of industry code governance that should be considered in this review?

Next steps

Please send your response to industrycodes@ofgem.gov.uk by **26 June 2015**. We will publish consultation responses on our website. Please mark your response as confidential if you do not want it to be published.

This is an initial consultation and, subject to responses to this consultation, we expect to consult on more detailed proposals for potential change in late summer 2015. We will also hold a stakeholder workshop to provide a further opportunity to seek your views. We will issue an open invitation to a workshop on our website in the coming weeks.

Yours faithfully,

Maxine Frerk
Senior Partner – Smarter Grids & Governance

Annex 1: Review of CGR reforms and further potential reforms

1. Introduction

1.1. This annex discusses some of the key reforms introduced by CGR (and where relevant extended to other codes under CGR2). We have grouped the key CGR reforms we are reviewing into four broad areas:

- Significant Code Reviews (SCRs)
- Self Governance
- Code Administration
- Governance of charging methodologies

1.2. For each of these four areas, we summarise below the reforms we introduced under CGR. We also set out our views of the effectiveness of these arrangements, and initial views on potential further reforms, to build on our CGR.

2. Significant Code Reviews

2.1. The SCR process was introduced by CGR to enable Ofgem to lead holistic reviews, to deliver complex and/or cross code changes. We set out in our March 2010 final proposals document that we would give as much notice as possible and consult with stakeholders before undertaking an SCR, where possible flagging it in our Corporate Plan. We also noted that we did not expect to undertake more than one or two SCRs per financial year.

2.2. We set out a standard template and process for SCRs. The process, broadly speaking, is made up of two phases:

- *Ofgem-led phase*:
    - o we consult on our intention to undertake an SCR and its scope
    - o if we decide to undertake an SCR, we consult with industry (through written consultations and work groups) to develop and assess options
    - o at the end of this phase, we issue our conclusions and, if appropriate, an SCR direction to a relevant licensee to raise a code modification(s)
- *Industry-led phase*:
    - o a licensee raises a modification proposal in accordance with our direction
    - o the modification is developed and assessed by industry, alongside any alternatives, through work groups and industry consultation
    - o the panel makes a recommendation on whether we should approve or reject the modification proposal or any alternative, and it is sent to us for a decision.

2.3. We make our decision on the proposed modification(s) following the industry led phase and panel recommendation.

2.4. We set out that the process may vary on a case by case basis according to the complexity or contentiousness of the issues at stake, and that we would keep this under review in light of experience of the SCR process. In addition, we set out that the precise duration of an SCR would also vary according to the complexity of the issue, but we expected that the Ofgem led phase described above would take no longer than 12 months in most cases, the industry phase 6 months and that we expected to make our decision within 25 working days.

2.5. We initially proposed a back stop power for Ofgem to draft code modifications. While we did not agree with those who opposed this power on the grounds of unfairness, and

the Competition Commission (the predecessor to the Competition and Markets Authority (CMA)) agreed with our views, we did not proceed with this proposal.

Our views on effectiveness of the SCR process

2.6. For the avoidance of doubt, we are not reviewing the effectiveness of the SCRs we have undertaken to date in respect of the policy issues they addressed. Our review is limited to the SCR process itself.

2.7. We consider that the SCR process has been effective in enabling us to lead reviews and propose wide ranging reforms in a number of important areas where we have had longstanding concerns about the need for change, ie gas security of supply, electricity "cash out" and electricity transmission charging.

2.8. These are the areas covered by the three SCRs we have launched to date: the Gas SCR[12], Project TransmiT[13] (our SCR on electricity transmission charging arrangements) and our Electricity Balancing SCR (EBSCR)[14]. We have also announced our intention to launch an SCR later this year to deliver faster switching[15]. This number of SCRs is broadly consistent with our view under CGR that we would not expect to undertake more than one or two SCRs in a financial year. We also note that in each case, the steps followed matched our high level guidance[16] on the process (for example, giving notice to industry of our intention to undertake an SCR, and consulting through written documents and workshops).

2.9. However, we recognise that the timescales for completing SCRs has in each case been longer than the indicative timetable we anticipated under CGR (please see table 1 below). We recognise that in some cases both Ofgem's process and the industry led stage of an SCR have taken longer than we initially expected. This may be because we underestimated the level of analysis and resource necessary for delivering the type of complex reforms that are taken forward under an SCR. There may be other factors influencing the timescales, such as the overall complexity and granular detail involved in the process. The level of industry engagement and participation in the process may also have been an influencing factor. We would welcome your views on this, and how the Ofgem and industry stages of the process could be better streamlined.

Table 1: Timings of SCRs launched since 2010

	SCR Launch date	*Ofgem Direction*	*Panel recommendation*	*Code mod decision*	*Total duration*
Gas Security of Supply	Jan 2011	Sep 2014	n/a*	n/a	44 months
Electricity Transmission Charging (TransmiT)	July 2011	May 2012	June 2013	July 2014	36 months
Electricity Balancing	Aug 2012	May 2014	March 2015	April 2015	32 months

* no industry led process/panel recommendation as we directed changes to the UNC using powers under s.36C of the Gas Act

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[12] https://www.ofgem.gov.uk/gas/wholesale-market/market-efficiency-review-and-reform/gas-significant-code-review-scr
[13] https://www.ofgem.gov.uk/electricity/transmission-networks/charging/project-transmit
[14] https://www.ofgem.gov.uk/electricity/wholesale-market/market-efficiency-review-and-reform/electricity-balancing-significant-code-review
[15] https://www.ofgem.gov.uk/ofgem-publications/93224/fastandreliableswitchingdecisionfinal.pdf
[16] https://www.ofgem.gov.uk/ofgem-publications/61740/guidanceintiating-and-conducting-scrsfinal-draft110810.pdf

Our initial views on further potential reforms

2.10.   We note that in all of the SCRs we have led, we have undertaken multiple consultations with the industry – either through the initial Ofgem-led phase, or in order to make a final decision on a code modification. We consider it is important to ensure a robust, transparent and consultative process to inform our conclusions and any SCR direction. In some cases, additional consultation has been required where matters have been identified at a late stage, or where we required additional evidence and analysis from the industry, that may not have been provided through earlier consultation. We would welcome views on our consultation processes under the SCRs, and whether there are alternative approaches to ensure that all relevant industry participants are fully engaged throughout the process and that Ofgem is provided with necessary evidence and analysis in the timeliest way.

2.11.   As noted above, under our CGR initial proposals, we considered a backstop power for Ofgem to draft modifications. While we did not proceed with this in our final proposals, we observe that having this option may be one means of reducing the timescales for the overall SCR process. We would not expect to use such a power in all cases, and we anticipate that were we to use any such power, we would continue to rely on industry input to develop the detail of any modification (for example, through work groups facilitated by Ofgem). We consider that having this option may be appropriate in order to ensure that changes resulting from SCRs can be implemented in the most effective and efficient way.

2.12.   We also note that while we can direct a licensee to raise a modification, we currently have no explicit power to direct the timetable the modification should follow. We note that we have this power in other areas, such as under the provisions that enable us to direct a licensee to raise a modification to implement or comply with the third package regulations[17]. It may be appropriate to introduce a similar power in relation to modifications that we direct a licensee to raise following an SCR.

2.13.   We would welcome your views on the current SCR process, and whether there are changes that would enhance the process, or whether an alternative process may be appropriate in some cases.

2.14.   In particular, we would welcome views on whether we should have the ability to:

-   specify a timetable that any code modification which we direct should follow
-   draft a modification proposal in some circumstances, rather than this being undertaken through the standard industry process following our direction. In such circumstances, we would expect industry parties to continue to be closely involved in the development of any such modification, and for the panels to continue to have a role in voting on recommendations.

3. Self governance

3.1. In our CGR final proposals, we set out that introducing self governance arrangements to the industry codes would ensure that our resources are focused on those issues that are material to consumers or our other statutory duties. We set out our view that a significant number of modifications (potentially 50%[18]) could be addressed through self governance. We considered that this would have the potential to reduce costs and facilitate faster implementation of change proposals. We considered there was merit in the self governance process, even if the number of self governance modifications proved lower than we expected.

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[17] For example, under SLC C3(4)(ae) of the electricity transmission licence.
[18] This was based on a retrospective assessment of the preceding 12 month period during the development of our CGR proposals.

3.2. Under the self governance arrangements introduced by CGR (and extended under CGR2 to other codes), modification proposals should include the proposer's view on whether the proposal should be subject to self governance and the panel have a role in assessing whether a proposal meets the self governance criteria. We have the ability to override the panel's view on self governance status. The self governance arrangements provide for panels to make decisions on self governance code modifications, with parties having a right of appeal to Ofgem.

Our views on effectiveness of the self governance arrangements

3.3. We consider the introduction of self governance has delivered significant benefits in the code arrangements. We recognise that the number of modifications that have been taken forward as self governance is not as high as we anticipated in our original impact assessment for CGR and there are variations in the use of the self governance mechanisms between the codes. However, we note there are still a significant number of modifications being delivered under self governance arrangements, at least 30% per annum across all of the codes. We consider this reform has been successful in enabling effective and efficient delivery of those changes without material consumer or competition impacts, allowing us to focus resource on more material changes.

Our initial views on further potential reforms

3.4. We would welcome your views on the effectiveness of the self governance arrangements generally, and whether they are applied effectively across all the codes. We would also welcome views on whether the self governance criteria set out in the licences remain appropriate.

4. Code Administration

4.1. We introduced a number of reforms related to code administration under CGR, including:

- *'Critical friend' role for the code administrator*: CGR identified activities that the code administrators should provide as a minimum, including assistance to smaller participants and consumer representatives with the drafting of modification proposals and their involvement in the change processes. We also noted that such parties may suffer from an asymmetry of information compared to larger participants and that the code administrator could provide access to information, where reasonably available to them.
- *CACoP:* this is aimed at aligning the code governance processes and contains the principles to be adopted for code administration. It also sets out performance metrics that the code administrators should report against. We introduced a licence requirement that code administrators and the code modification processes must be consistent with the principles in CACoP (to the extent relevant).

4.2. We also introduced a number of other reforms including independent panel chairs,[19] provisions to enable us to 'send back' modifications where we identify deficiencies in the final report and an explicit requirement for panels to provide reasons for recommendations and decisions.

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[19] For CUSC and UNC, extending the approach under BSC to these codes.

Our views on the effectiveness of code administration reforms

Critical friend

4.3. The role of the code administrator as a critical friend, as required by the relevant licence obligations and as set out in the CACoP, plays an essential part in helping smaller parties to engage with the codes and the code modification process. A key aspect of this role is also to assist the involvement of smaller participants and consumer representatives in the change process. There are a number of different things the code administrators do to help smaller parties including the running of training sessions to improve understanding of the codes, providing plain English summaries of code modifications as well as the code processes themselves, and providing forums for smaller participants to ask questions about current live modifications. However, we are aware that smaller parties continue to face difficulty engaging with the codes, and find it harder to resource activity in this area.

4.4. We recognise that to some extent, this is a product of the complexity of the industry. However, we consider that there may be scope for greater use of the critical friend role to further support smaller parties in particular. It may currently be underutilised by smaller parties, potentially due to lack of awareness as to what this role includes, and we would welcome views on this. There may also be different approaches to the role under different codes, and potentially scope to extend 'best practice' across the codes. There may be more proactive measures industry can take to ensure smaller parties' views are represented, given they are likely to find it harder to resource working group attendance than larger parties.

CACoP

4.5. We continue to consider there is scope for CACoP to play a key role in better aligning processes across codes and establishing best practice in code administration. We welcome the steps the code administrators have taken already to align with CACoP, for example providing accessible and relevant information on websites and providing some support to parties throughout the pre-modification process. However, there remain differences across the codes, which can add to the complexity in engaging in the code change process. In addition, there is a risk that poor coordination of change across codes could impact timely delivery of necessary and beneficial change to the codes.

4.6. CACoP also introduced performance metrics for the code administrators to report against. These were intended to be a means to ensure benchmarking and transparency on relative performance of the code administration processes. However, we do not consider that so far they have been demonstrated to achieve this. In part, this may be due to differences in reporting across the codes, which makes it difficult to meaningfully compare the data, and potentially increases the difficulty in establishing engagement in this across the codes.

4.7. We welcome the work the code administrators have been doing to introduce an annual review process for CACoP through which they can seek feedback from code users, and the recent proposal to add a new principle to CACoP to require cross code coordination. However, we think further reforms may be needed to address ongoing inconsistencies in the code change processes, and in particular the difficulties faced by smaller parties in engaging with the codes. The volume of code change at any time may add to the difficulties smaller parties face engaging with codes, as well as the inability to predict when a change may be brought forward (given this is entirely dependent on the proposer). There may be more effective ways to manage the change process and timings of changes, which may help smaller parties determine how best to use their resources for code engagement.

Other issues

4.8. As noted above, we are aware that smaller parties may find it harder to resource code engagement compared to larger parties. This leads to concerns that panels and working groups are more likely to be dominated by larger parties. We think reform to panel composition and improvements to the working group arrangements may be needed to mitigate any risk that larger parties may have greater influence/input to code processes.

4.9. One way to help achieve this may be to better align the decision making processes across the codes. Certain codes operate a party voting system in respect of proposed code modifications. While this may be seen as a democratic and inclusive way of identifying the level of industry support for code change, it may not necessarily be an effective way of ensuring that change recommendations and decisions are properly made in reference to the applicable code objectives, as required under the relevant licence conditions for each code.

4.10. As part of the original CGR scoping exercise we considered whether there was a need for code objectives to align with our statutory duties and principal objective to protect consumers. This was ruled out of scope of the CGR.[20] While we do not consider that this should be revisited, we recognise that there may be scope for consumer impacts to be better considered during the code modification processes and we would welcome ideas on how best to achieve this.

Our initial views on potential further reforms

4.11. We think there is merit in further consideration of how the code administration arrangements can better support smaller parties and result in more effective modification processes. In particular in light of our ongoing concerns that the current arrangements may not be delivering timely change in consumers' interests.

4.12. For example, we see merit in considering the following as potential areas for reform:

- More 'strategic' panels/proactive industry management of the modification process: we welcome views on how code panels, code administrators and the wider industry can work more strategically to improve the code modification process. For example, this could be through providing a forward work plan for the year to enable more efficient planning and allocating of resources throughout the year. Another option may be to have a more managed process for bringing forward change (eg a change window) in some areas.

- Independent panels: We note that some codes require independent panel members, (i.e. where voting members must act impartially and not represent the interests of their employer and/or constituency) whereas other panels rely on representative voting. There may be benefits in extending the independent panel member requirement to other codes, to ensure that code modification decisions and recommendations are made on an impartial/objective basis.

- Improvements to work group processes: We note that some codes provide independent chairs at work group meetings and there may be merit in requiring that all work groups have an independent chair. This may help support smaller party representation. There may also potentially be benefits in requiring that independent and impartial expertise is appointed to work groups in certain circumstances.

- Consumer impacts: we would like views on how the industry can better report on consumer impacts of proposed modifications in order to aid engagement of all relevant parties. For example, a section could be added to all modification reports to give a

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[20] https://www.ofgem.gov.uk/ofgem-publications/61469/govrevscope-mf-final-30-june-08.pdf

description, where relevant, of how the modification would affect consumers, what type of consumers would be affected and an approximation of how many consumers would potentially be affected. Potential consumer impacts could initially be identified by the proposer of a modification and updated as necessary throughout the modification process, allowing all parties to effectively engage with the development of the potential solution.

5. Governance of charging methodologies

5.1. Under CGR, a number of charging methodologies[21] were brought into the industry code governance arrangements. We considered that this would improve accountability, accessibility and transparency to users, and enable network users and materially affected customers to bring forward changes. We considered it would also allow charging and non-charging code changes to be considered together. We envisaged that existing charging methodology forums should continue to be the main arena for discussion of issues related to methodologies.

5.2. We acknowledged the concern that parties would bring forward a significant number of modification proposals, which could increase administrative costs and result in regulatory uncertainty. One potential mitigation measure we considered was that a 'change window' could enable network licensees to plan effectively and rationalise parallel proposals where appropriate. We suggested there may be merit in adopting a three month change window; however we set out that it was for the network licensees to develop an appropriate process.

Our views on effectiveness of the governance of charging methodologies

5.3. We consider that the inclusion of charging methodologies within the governance of industry codes has been successful in enabling more parties to engage on charging changes. Some of the codes have experienced a relatively high volume of charging change. While this had not proved to be unmanageable, there may be practical ways to manage the process more effectively. Overall, we continue to consider that there are benefits of including the methodologies within the relevant codes. It enables more parties to engage directly by raising proposals and contributing to the development overall of more effective and efficient methodologies; however we also recognise there a number of issues with the current arrangements.

5.4. For example, we anticipated under CGR that existing charging forums should be the main arena for discussion of issues related to methodologies. We considered these forums could act as an effective filter prior to the formal raising and development of charging changes. We also encouraged network licensees to introduce an appropriate process to plan and rationalise parallel proposals once raised, such as use of a change window. However some users have expressed concerns that the approach of network operators in some cases may impact users' willingness to use charging forums for further development before formally raising charging changes.

5.5. We anticipated that network operators would support parties in bringing forward change if appropriate. We expected that the governance arrangements would make

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[21] The gas and electricity transmission connection and use of system network charging methodologies and the gas distribution use of system network charging methodologies. Subsequently, the electricity distribution charging methodologies were also brought into industry code governance. Our decision to implement a Common Distribution Charging Methodology (CDCM) through DCUSA (November 2009) is here: https://www.ofgem.gov.uk/ofgem-publications/44179/cdcm-decision-doc-201109-2.pdf. Our decision to deliver the electricity Structure of Charges project for extra high voltage charging and associated governance arrangements (July 2009) is here: https://www.ofgem.gov.uk/publications-and-updates/delivering-electricity-distribution-structure-charges-project-decision-extra-high-voltage-charging-and-governance-arrangements. Our decision to facilitate changes to the Common Connection Charging Methodology (CCCM) through open governance (June 2012) is on our website here: https://www.ofgem.gov.uk/publications-and-updates/making-changes-electricity-distribution-common-connection-charging-methodology-decision-modify-electricity-distribution-licence-facilitate-open-governance

network operators increasingly accountable to other parties for their charging methodologies as well as making the methodologies both transparent and accessible.

5.6. Our view under CGR was that changes to charging methodologies have significant impacts on competition and consumers and regulatory oversight remains important. Our CGR2 changes extended self governance in the Distribution and Connection Use of System Agreement (DCUSA). We reiterated that we expected charging changes would not usually meet the self governance criteria. However, we noted that there may be circumstances where charging changes can be eligible for self governance, for example, those of a 'housekeeping' nature which have no impact on the charging levels.[22]

Our initial views on further potential reforms

5.7. We note that broadly speaking the processes adopted for charging methodology changes are the same as those that were already established for non-charging code changes. We consider the charging methodology change processes across the relevant codes[23] may benefit from a more managed process, including a more effective pre-modification process. For example, a pre-modification process could enable issues to be considered in the round prior to entering the formal change process, with greater and earlier understanding of changes. This could enable consideration of how potential changes relate to each other and how they meet policy priorities (eg realisation of the benefits of smart meters/grids).

5.8. In addition, we think there is merit in considering again if a modification 'window' (within which change may be raised and assessed) may be appropriate. This could potentially better ensure that charging modifications are developed and considered in the round, and enable better prioritisation and planning of changes[24]. We would welcome your views on this. Again, there may be merit in this applying in areas other than charging and we would welcome views on this.
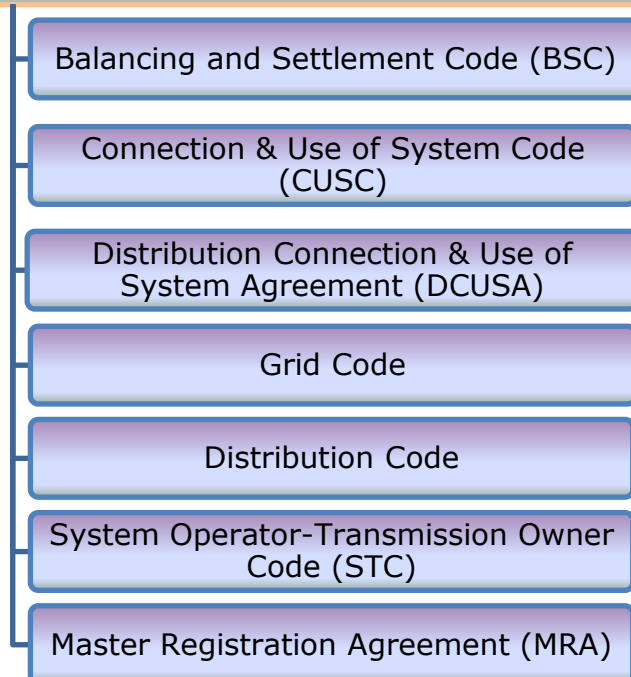
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[22] Our decision of DCP170 (December 2013) is available here: https://www.ofgem.gov.uk/publications-and-updates/distribution-connection-and-use-system-agreement-dcusa-dcp170-code-governance-review-phase-2-changes

[23] The relevant codes incorporating charging methodologies are the Connection and Use of System Code (CUSC), the Uniform Network Code (UNC) and the DCUSA.
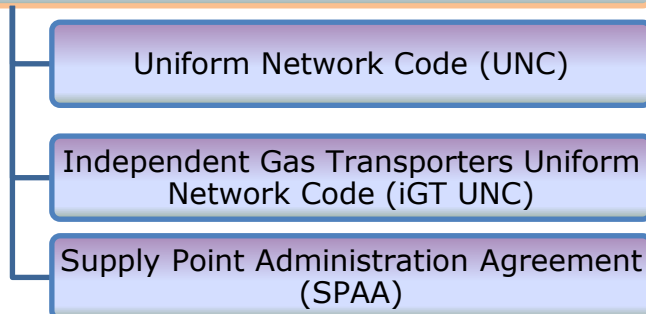
[24] We recognise this may result in change raised in a given 'window' needing to be developed over longer timescales and not necessarily delivered for that charging year.

Annex 2: Overview of main gas and electricity codes

Electricity

- Balancing and Settlement Code (BSC)
- Connection & Use of System Code (CUSC)
- Distribution Connection & Use of System Agreement (DCUSA)
- Grid Code
- Distribution Code
- System Operator-Transmission Owner Code (STC)
- Master Registration Agreement (MRA)

Gas

- Uniform Network Code (UNC)
- Independent Gas Transporters Uniform Network Code (iGT UNC)
- Supply Point Administration Agreement (SPAA)

Electricity + Gas

- Smart Energy Code (SEC)