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26 June 2015

Dear Ms Frerk,

We appreciate the opportunity to respond to your Open Letter (Letter) on industry code governance.

Citizens Advice is the statutory consumer representative in the industry code governance framework. We have membership and voting rights on a number of the modification panels and can raise modification proposals on most codes.

As you recognise in the first paragraph of the Letter, the energy system is undergoing structural changes which is placing major stresses on the rules that underpin the operation of the market. In our view, it is becoming increasingly clear that despite the changes you implemented as a result of the Code Governance Review (CGR) and CGR2, they are challenges the codes cannot meet in their current form and major reform is needed to make them fit for purpose in this new environment. In this submission we describe these problems and propose actions you might take to resolve them.

We are conscious that we make this submission ahead of the CMA's expected release of its provisional findings, findings which will likely extend to code governance under its fifth theory of harm. The evidence, analysis and recommendations in this area are obviously pertinent to this review and we reserve the right to revisit the points we make in this submission should it be appropriate.

Please do not hesitate to contact me if you would like to discuss this submission further.

Kind regards

C Alexander.

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Question 1: *Do you consider the governance change 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?*

We do not believe that the headline CGR and CGR2 reforms, in particular the introduction of the Significant Code Review (SCR) mechanism, have been effective in streamlining the code change process. The gas security of supply SCR, launched in January 2011, is yet to be implemented but this should take place in October 2015 – four years and 9 months after inception. The electricity transmission charging SCR, launched in July 2011, is due to be implemented in April 2016 – also four years and nine months after inception – and is currently subject to a judicial challenge. The electricity balancing SCR, launched in August 2012, saw Ofgem reject proposals that it itself effectively instigated (P304 and P314), and will be implemented in November 2015, three years and three months after inception. While the SCR process appears to have been intended to allow the regulator to grab important issues by the scruff of the neck and drag them forward, its practical effect has been the opposite with these projects conspicuously lacking momentum and make very slow progress.

Beyond the SCR, the BSC P272 experience shows the limitations of the Code Administrators Code of Conduct (CaCOP), which as non-binding guidance, does not provide code administrators and panels with a mechanism to step outside the confines of prescriptive and inflexible modification processes to manage change in a coordinated way. Although we see the creation of the new CaCOP Principle 13 as a positive development, it is essentially guidance about good working practice and does not address the core problem of how you align multiple, highly prescriptive and inflexible change processes governed by separate bodies within confined terms of reference. We do note though that in our experience as the consumer representative, dealing primarily with Elexon and Xoserve, these organisations are responsive to questions and quick to lend support when it is sought.

It is difficult to assess the success of the self-governance mechanism, but our impression is that while it is good in theory, panels are often reluctant to assume responsibility as the final decision-maker. There are also examples of minor changes that appear to be obvious candidates to progress down an expedited self-governance route taking an inordinate period of time to complete. We note that a modification to amend the Uniform Network Code (UNC) to replace the fax with email as the valid form of communication has so far involved more than a year of wrangling between code parties (including the withdrawal of an initial modification and the substitution of a new but essentially similar proposal) without resolution.[1]

We do not believe incremental reform of the kind you suggest in your letter will be sufficient, although we are open to the idea of you assuming a more central role in developing and delivering large-scale reform via a strengthened SCR power. One of the key issues is that the code modification process that follows the completion of an SCR provides an opportunity for the high-level 'policy' issues, that should have been already been settled, to be re-litigated rather than simply for the fine detail of the policy to be filled in. The fact that everyone knows (regulator included) that the SCR is not the 'end of the road' so to speak, introduces a moral hazard problem where decisions on key issues can be deferred or inadequately

thought out, or parties can decide not to fully engage because the impact is not sufficiently immediate and/or final. Of course another quite different way of solving this problem might be to run a much quicker, lighter-touch SCR, that sees issues referred to the codes earlier. But given the 'public policy' dimensions of the sort of issues that would ordinarily be referred down this route, this would only be appropriate in the scenario where the decision-making criteria under the codes were broadened to include consumer interest criteria (as we expand on in response to Question 3 below).

These issues were a feature of the Electricity Balancing SCR, where after two years of intensive analysis and engagement, core recommendations – how price average reference (PAR) would move from PAR500 to PAR1 and the stage at which the conversion would be made to a single cash-out price – were overturned at the code implementation phase. This is not to say that this was the wrong outcome, but a question we would like to see you explore in this review is whether the code process truly flushed out new evidence, or provided a vehicle for different analysis to be undertaken, that was either not available or not possible during the SCR phase? Our impression is that the answer to this question is no, which suggests to us that either the SCR must be strengthened to deliver more fully formed, binding decisions, and/or the code implementation process should be confined to genuine questions of implementation according to a set timetable.

This review is also an opportunity to deal with the outstanding inconsistencies between the governance arrangements for the codes that were not ironed out by the CGR and CGR2. Differences between codes as to when and how parties can raise alternates is one of the most obvious: the more confined approach under the BSC appearing to limit what appears (at least from the outside) to be the tactical use of the feature to at best complicate and worst frustrate change under the UNC. One recent UNC proposal, *'Treatment of Existing Entry Capacity Rights at the Bacton ASEP to comply with EU Capacity Regulations'*, triggered three alternates, all of which were subsequently varied, presenting the panel, and subsequently Ofgem, with a decision of almost comic levels of complexity.[2]

We would also note that Citizens Advice is currently unable to take up its place as consumer representative on the Smart Energy Code (SEC) Panel (which we attend only as an observer) because its drafting states that Panel members are required also to become Board Directors of the Smart Energy Code Company (SECCo), a commercial entity which would pose a conflict of interests for us an independent consumer advocate.

Question 2: *Do you agree 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?*

It is paradoxical that the massive bureaucracy that is the code governance framework is one of the defining features of our privatised energy market. It is telling that constructing a simple institutional map of the codes and their interrelationships is itself a major academic exercise. It is not surprising that a system with this many moving parts and interdependencies is resistant to change. [3]

In our view the reason the SCR and other changes you introduced under CGR and CGR2 have not achieved their objectives because they are about streamlining the change process rather than directly address the underlying complexity of the codes. We do not believe the problem is just about 'how' you effect change but rather it is also 'what' you are trying to change. This

is at least part of the reason why matters emerge or require additional analysis late in SCR processes (as you detail at paragraph 2.10 of the Open Letter) because in complex frameworks foreseeing all the issues you might need to deal with at the start of the process is difficult if not impossible.

We therefore urge you to consider how the codes might be simplified and even consolidated as part of this review. This is also important because complexity is not just a barrier to timely change, but it is also increases the day-to-day compliance burden for market participants, particularly smaller players and/or new entrants who may not have the resources to dedicate staff exclusively to code governance.

The complexity and inaccessibility of the codes will also become a much bigger problem as we move from the old centralised energy system with a small number of large traditional actors, to a more decentralised one with a larger number of smaller actors, including domestic consumers who will be engaging in the market in new ways; not only by generating their own power, offering demand side response but no doubt in other ways we don't yet know about. These new actors will have a legitimate interest in the market rules but as it stands are effectively excluded from the governance process that underpins them, not least because of the resources you need to navigate the process.

The stresses this new market landscape will place on code governance are evident in the development of the new European network codes that will also apply in GB. In an early draft of the Emergency and Restoration Code, ENTSO-e sought to give TSOs powers to impose direct compliance obligations on domestic energy customers with self-generation over a certain threshold and/or who are party to a DSR arrangement. This absent NRA oversight or any thought being given to whether it was right or proper to extend a set of industry rules 'into the home', to a set of people who had no say in their development. [4] Although the debate at a GB level is perhaps less advanced, modifications are also coming forward to open up the GB codes up to a wider range of actors: in the BSC for example, P321 *'Publication of Trading Unit Delivery Mode'* and P315 *'Publication of Gross Supplier Market Share Data'* have recently been proposed to deal with issues associated with the rise of distributed generation. Ensuring the change process engages with all the relevant stakeholders with an interest in these modifications will be critical for legitimacy of the solutions that are ultimately recommended to Ofgem.

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

We strongly believe for the objective decision-making criteria that are embedded in the codes should be aligned with Ofgem's statutory duties. As it stands, panels assess modifications against a narrow set of 'efficiency' and 'competition' criteria, while Ofgem, at the end of the process, does so against its broader statutory duties headlined by its principle objective duty to 'protect the interests of current and future consumers'.

While we understand the intent is for modifications to be assessed against an objective and simple set of criteria that are familiar to industry, in practice the lack of a direct link to

outcomes contributes to analysis and debates taking place at an unhelpful level of abstraction from the real-world impacts of the proposals.

A good example of this was a recent modification, UNC 0535, *'Implementation of Non Effective Days to enable Annual AQ Review (independent of Nexus transition)'*, as the name suggests, sought to insert two extra days into the standard switching time frame at a fixed point every year to allow market participants to process certain data. The proposal was supported by industry on the basis that it would ensure critical data validation and processing could take place at a lower cost and with less risk of error. But there was no meaningful consideration in either the industry representations or in the modification report of consumers' opportunity costs associated with a longer switching time frame. The only clue that there might even be a downside that needed to be considered was in E.ON's representation, that noted that "initial analysis indicates around 4k customers might be impacted by these non-effective dates".[4]

This failure to consider the full range of cost and benefits is most evident in modifications that come forward to delay the implementation of major system upgrades or changes to the market rules. As far as we can tell for example, no attempt has been made to assess or even quantify the consumers' foregone benefit from a delay to Project Nexus – benefits that presumably run into the millions of pounds given the quantum of the upside identified in the original impact assessment for the package.[5] The word 'consumer' does not even feature in the paper Xoserve presented to a Project Nexus Steering Group meeting setting out the reasons why a partial deferral was necessary,[6] while the (now withdrawn) delay and deferral modifications UNC 0535 and 0536 do not identify forgone consumer benefits as something the workgroups for each modification should consider as part of their assessment.

Of course there are two checks built into the framework to deal with this sort of problem: the first line of defence being the consumer panel representative; and the second being Ofgem in its role as the final decision-maker. But in our experience, the heavily technical nature of the subject matter, the absence of information about consumer impacts, and a disproportionate focus on procedure over substance at panel meetings – the substance being dealt with at a working group level – limits our ability to spot issues and pose effective challenges. And while Ofgem assesses the modification against its broader statutory duties, this happens at the end of the process by which time assumptions have become entrenched and momentum built up behind solutions. Having Ofgem intervene late in the process to test basic assumptions also seems inefficient, something the Brattle Group highlighted in its report for the CGR.[7]

Introducing a consumer objective would flush out issues at an earlier stage of the process and provide a 'point of entry' into the debate, not only for consumer representatives but also smaller and/or non-traditional actors who may not be energy industry insiders who are familiar with code argot. To ensure this information is not lost in the change documentation, we also suggest that a specific 'consumer impact' section is added to the modification templates. The expectation would be that this section record high-level information about who is affected (e.g. domestic pre-pay customers, geographic location etc.), how they are affected (e.g. costs, standard of service etc.) and an indication of the overall costs and benefits (with an attempt to factor-in opportunity costs). This should not prove an onerous task for industry who should already be considering all of these factors in addressing the

existing competition, efficiency criteria but often fail to do so explicitly as we have detailed in the examples above.

The other point we would make here is that the introduction of a consumer objective could provide a safeguard that would give stakeholders the confidence that a greater number of modifications could be progressed down the ordinary and self-governance modification routes, potentially freeing up Ofgem's resources to focus on evaluating major changes.

Endnotes

1. http://www.gasgovernance.co.uk/0522.
2. See in particular page 21-34 of the final modification report, which attempts to make sense of stakeholders views on the four modifications http://www.gasgovernance.co.uk/0501
3. See map constructed by Bridget Woodman, Exeter University, and accompanying blog here http://blogs.exeter.ac.uk/energy/2014/11/12/mapping-the-power-in-the-electricity-system/
4. See Article 38(1) of this draft of the Emergency and Restoration Code https://www.entsoe.eu/Documents/Network%20codes%20documents/NC%20ER/141013_NCER_Draft_for_Public_Consultation_V1.0.pdf
5. http://www.gasgovernance.co.uk/0535
6. The Project Nexus package as a whole was estimated to deliver quantitative benefits of more than £11 million pounds per year – see page 4 http://www.gasgovernance.co.uk/sites/default/files/UNC432D%20.pdf.
7. http://www.gasgovernance.co.uk/sites/default/files/Nexus%20SG%20Xoserve%20Retrospective%20Adjustments%20and%20Unique%20Sites%20Deferral%20Paper%2010042015v1.0.pdf
8. Page 4, Critique of the Industry Code Governance Arrangements, Brattle Group, June 2008 http://www.brattle.com/system/publications/pdfs/000/004/861/original/Critique_of_the_Industry_Codes_Governance_Arrangements_Hesmondhalgh_Jun_2008.pdf?1378772135