

30 June 2014

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Dear Maxine

**Response to Ofgem's further review of industry code governance**

Thank you for the opportunity to respond to your further review of industry code governance dated 15 May 2015. This response is from the ENA's Gas and Electricity members but not SSE Power Distribution or Scottish Hydro Electric Transmission<sup>1</sup>. This response highlights concerns regarding the current industry code governance. In your letter, you asked for a response to some particular questions, please find ENA's responses below:

**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?**

General

We agree that it is important to ensure the various code governance arrangements are fit-for-purpose for a changing industry. This includes ensuring that newer parties can engage with code governance while also taking account of the increasing pace, volume and complexity of industry change planned in the coming years. ENA members believe that, on the whole, code governance arrangements are transparent, efficient and easy to access for those parties that wish to actively engage with change processes. In addition, the codes are well supported by helpful and responsive code administrators.

Over-reliance on specialist knowledge from small community of experts

The development of some change proposals can seem over-reliant on working groups recruited from relatively small communities of committed industry specialists employed by code parties. These specialists are generally employed by larger companies rather than from smaller or newer parties. Given that these individuals also have other priorities and commitments, and all parties are subject to cost and resource pressures, their contribution to industry development should be acknowledged and not underestimated in relation to any further enhancements that Ofgem may wish to see.

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<sup>1</sup> Hereafter, references to 'our members', 'ENA' or 'we' do not include either of these companies.

The contribution of specialist knowledge must not be misinterpreted as domination by larger parties, because without this contribution few change proposals would actually be developed to a point being able to progress through to the point of implementation of the proposed change. Ofgem should not only consider access arrangements for smaller and newer parties, including the encouragement of consultation responses and party voting, but also how to encourage early and sustained engagement by such parties in the development of changes.

#### Accessibility to all code parties

While arrangements for the various codes can be slightly different, we believe that, in the round, the current arrangements provide ample opportunities for parties (smaller or larger) to engage if they wish to do so. We note that code parties:

- Are invited to code education and update sessions (generally free of charge);
- Can see new change proposals as they are published for all parties and are notified to individual parties;
- Can discuss change proposals with helpful code administrators;
- Receive sufficient notice to join working groups;
- Are consulted on changes;
- Can make representations to working groups, code administrators and code panels;
- Have opportunities to vote; and
- Can appeal decisions.

Despite such clearly accessible arrangements it remains unclear why some parties opt not to engage with code administration while others more fully engage with industry change. In this area we would highlight examples that our members have noted:

- Significant code changes that have drawn noticeable low participation in terms of responses to consultations and voting;
- Concerns expressed about specific changes, post approval, even though the change development processes has been lengthy and fully transparent; and
- Recent change proposals to extend implementation dates in relation to well publicised approved changes.

Even code changes directly affecting the parties themselves can have low participation. To take one example; DCUSA DCP178 – 15 month notice for Distribution Use of System charges where only four of the ‘big six’ suppliers and only three of the other suppliers voted. Consequently, we would be concerned if further developments, such as requirements for independent chairs, led to further additional code administration costs without actually securing additional engagement. Such further developments should only take place if there is relative certainty that party engagement would improve as a result. We see no evidence that this would be the case at present.

#### Process efficiency and self-governance

Larger code changes are often supported centrally by clear Ofgem direction through Ofgem policy decisions or working groups instigated at Ofgem’s request. By contrast, the efficiency of smaller industry code changes can be adversely affected by the lack of access to Ofgem’s views early in the change development process.

Whilst there are obvious requirements for Ofgem not to fetter its discretion in relation to subsequent formal decisions to approve or reject individual changes, early clear input from Ofgem can have a significant impact on the efficiency of the change process. For example, parties can appreciate why Ofgem needs to reject changes that it feels are not supported by proper analysis. However it is unclear why Ofgem's representatives on working groups cannot provide such feedback earlier in the change development process. Ofgem may need to consider providing clearer guidance for its representative's participation in working groups to support industry change processes. Appropriate support should avoid surprises late in the process and reduce wasted working group activity.

Where there is a requirement for change but no obvious party to take the lead and/or the code implications are not clear, strong central direction from Ofgem may also be useful. In some cases it may not be efficient for an individual party to lead a change where multiple parties and or consumers are affected. There may need to be overarching guidance, as a minimum, in respect of new industry developments prior to individual parties raising changes. Third party supply access on private networks is a good example of a topic which may have suffered from incomplete direction at the outset with an over-reliance on distributors to address specific issues. A more centrally coordinated approach could have led to better outcomes for customers.

A further concern in relation to overall efficiency of code governance arrangements are exemplified by recent industry code change proposals to delay the implementation of previously approved changes that have effects on consumers<sup>2</sup>. In such cases late concerns have been voiced about Ofgem approved changes by industry parties whose concerns that were not clear previously or not sufficiently amplified. This suggests that better processes are required to get early engagement from parties and not allow other parties to waste time developing modification proposals which are subsequently delayed at the last minute.

It may be worthwhile drawing a distinction between code changes that solely affect arrangements between parties and those that have consequential effects on consumers. For the former the normal code consultation processes should be sufficient but the latter may benefit from an enhanced consultation process. Energy suppliers/shippers have the primary relationship with consumers, therefore it is essential that suppliers/shippers are engaged (either directly or indirectly) with code changes that affect their consumers and that clear evidence of this engagement exists before such changes are approved. New ways of consulting and securing appropriate responses may need to be developed to ensure that suppliers (small and large) are aware of the effects that proposed changes will have on consumers and that sufficient assurance is obtained that suppliers/shippers can be prepared for implementation if approved. It is also important to ensure that changes are raised to the appropriate code, for example that retail market issues do not encroach on wholesale costs.

### Code Administrators

We fully support the principle of 'critical friend' role held by the code administrator and the practical way that the role offers assistance to both newer and longer established parties. However, we would be concerned about any significant

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<sup>2</sup> Balancing and Settlement Code (BSC) change P322 to delay the implementation of P272 (Mandatory Half Hourly settlement for Profile classes 5-8) and Distribution Connection and Use of System Agreement (DCUSA) change DCP242 to delay the implementation of DCP 161 (Excess Capacity Charges).

extension of the critical friend role, if that created additional costs. There would need to be convincing evidence that specific reforms would have a strong probability of delivering additional benefits. At present, we don't see how these benefits would emerge.

We note Ofgem's concerns on asymmetry of information. However, we would highlight that all parties see the same information from code administrators and have identical opportunities for engagement in the process steps. The only asymmetry arises from the fact that individuals in any working group developing a particular change proposal, may automatically and intrinsically have more information due to more committed personal engagement or specialist expertise. Even if the latter is relevant, all parties (large or small) that do not have working group members receive equal information through industry change processes.

#### Significant code review process

We consider that that the significant code review (SCR) process needs to be further considered. The Gas Security of Supply SCR took too long to conclude. Ofgem may need to consider further involvement of code administrators and code panels in implementing SCRs.

#### **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?**

Our members see no need to consider further significant reforms to the industry code governance arrangements, but do have a number of observations and suggestions across a range of topics as set out under the headings below.

#### 'Critical friend'

We note the important work done in this area, however this valuable role should not be further extended unless there was evidence that specific reforms would have a strong probability of delivering additional benefits.

#### Improvements in working group processes

Having considered Ofgem's potential areas for reform we would offer the following observations.

**Strategic industry management and change windows** – In principle we would support well thought out measures for the planning ahead of code activity. This would help with general priority setting and resource planning. Furthermore, there may be clear merits in prioritising change proposals aligned to 'change windows' for certain types of changes, including for charging methodologies. However, forward planning is difficult to reconcile against the current rights of code parties to bring forward what they see as necessary and timely changes. We can see less merit of change windows for codes which do not concern charging methodologies. Consideration of a change window needs to include the following factors.

- The need to avoid rushed development of changes, to meet prescribed timetables;
- Potential delays to urgent or necessary changes if the window is missed;

- Potential additional pressures on the limited number of individuals, experts and parties who typically support working groups, due to lost 'diversity' of change development timetables; and
- Potential 'rationing' of changes due to the potential limitation of available and appropriate working group members or support facilities within the window.

**Independent chairs** - Our members do not object to the principle of the provision by codes of independent chairs or independent expertise. This may ease the burden on existing industry experts who feel they should volunteers to chair groups for complex changes. However, there is already a significant cost of code administration and independent chairs would add to this. The inclusion of general purpose chairs may not deliver an appropriate level of additional support and risks adding an additional layer of costs for limited benefit. In addition, it is unclear how this may help support smaller party representation. Smaller parties might find it more economical and flexible to jointly fund experts to attend working groups and disseminate information on their behalf, rather than fund an independent chair. In addition, consideration needs to be given to the sourcing of people with a suitable level of specialist knowledge.

**Ofgem guidance** - Early clear input from Ofgem can have a significant impact on the efficiency of the change process and may indeed prevent wasted working group activity on change proposals that are ultimately rejected, or sent back due to lack of analysis.

**Consumer impacts** – The inclusion of better set out consumer impacts, including how the change would affect consumers and what type of consumers, would seem to have clear merits. This could be included in consultations and change reports even if the impact was not fully known to the proposer at the time of the initial modification proposal. This should help provide an insight into the size of the issues and help parties understand which of their customers are affected. While this additional visibility should help party awareness it is unclear whether this would in itself drive those parties to actively engage (for example where the consumer was affected in a quantifiable way but the party itself was neutral to the change).

**Consumer impacts and engaging code parties** – the current arrangements for codes to consult parties on changes are clear, transparent and are supported by friendly and efficient code administrators. Consequently, it remains unclear why so few parties respond to some code change proposal consultations, even on more significant changes or where there are consequential effects on consumers. It may be that because providing a response to a code consultation is optional and also because code changes typically have less impact than licence changes, parties may simply opt to prioritise other more pressing commercial activity. Where a code change has a consequential effect on consumers it is clearly important to gain comfort on the awareness that code parties have on the impact of the change. Ofgem may need to consider producing more of its own separate consultations on certain types of code changes if industry code consultations are failing to draw out sufficient party responses.

**Trialling any new arrangements** – Consideration should be given to trialling any proposed new arrangements to ensure they actually deliver the required outcomes before incorporating them formally into governance arrangements

or the code administrator's code of practice (CACOP). This should ensure appropriate outcomes for parties prior to adding costs to codes.

**Code costs** – If industry code management arrangements are to be enhanced in a way that significantly increases costs then the licensees that fund those costs should be provided with the means to secure additional income through price controls to cover those costs. Industry resources are already stretched in dealing with the volume of change and amendments to code governance arrangements could increase these costs further.

**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?**

We have highlighted a number of areas above which we believe should be considered as part of this review, including Ofgem's early input to working groups and potential for further Ofgem consultation on change proposals to secure increased engagement. We have also highlighted that Ofgem needs to take very careful consideration of the additional costs imposed by any changes it proposes. In addition, we would suggest that Ofgem looks at whether code panels could be given further powers to withdraw code modifications which have stalled in development. Finally, while we fully support proposals for cross code working, we would warn against having a single modification which spans across numerous codes. This would be difficult to administer and unlikely to lead to efficient development.

I hope that this response provides a useful input for your review. Should you need any additional information or have questions on the issues raised in this response, please contact [mark.askew@energynetworks.org](mailto:mark.askew@energynetworks.org).

Yours sincerely

A handwritten signature in black ink that reads "David". The signature is written in a cursive style with a long, sweeping underline that extends to the right.

David Smith  
**Chief Executive**