

Maxine Frerk
Senior Partner – Smarter Grids & Governance
Ofgem
9 Millbank
London, SW1P 3GE

29th June 2015

Submission via email:
industrycodes@ofgem.gov.uk

Dear Maxine

First Utility Response to Ofgem's Further Review of Industry Code Governance

Thank you for the opportunity to contribute to Ofgem's Further Review of Industry Code Governance (**Further Review**), which was announced in your open letter to interested parties on 15th May 2015. First Utility sees this Further Review as an important step to improving smaller and independent supplier engagement in industry governance more generally and in industry change processes in particular, with the ultimate aim of continuing to secure improvements for consumers.

We echo your welcoming of the inclusion by the Competition and Markets Authority (**CMA**) of issues around code governance as a new theory of harm in its updated issues statement. We set out some of our recent experiences, and our thoughts on addressing the challenges around securing greater smaller and independent supplier representation in code governance, in our response to the CMA.¹ We refer to that response in this letter where relevant.

Introduction

First Utility is an independent energy supplier, offering electricity and gas services to around 800,000 dual fuel domestic customers (having grown from just 52,000 customers at the end of 2011). More recently, we have gained experience in meeting the challenges faced by smaller and independent industry participants in engaging with the industry codes, the processes for governing and amending them.

We continue to see a lack of independent supplier representation in the development of industry rules and processes and believe that this impacts adversely on consumers and on all other industry participants. This is certainly the case in the areas we have been able actively to engage in: however, these are necessarily limited and we cannot comment more generally on the spread of independent and smaller supplier representation in code governance and workgroups more generally.

¹ https://assets.digital.cabinet-office.gov.uk/media/553e51a5e5274a1572000055/First_Utility_response_to_updates_issues_statement.pdf

The open letter also notes generally that the industry is facing significant change. We agree and note the continuing need to improve processes and update systems, which drives the continuing need for change and implementation programmes. We would highlight a number of points here:

- That the industry itself is changing, with a wider variety of participants than ever before. We believe the code governance processes are finding it hard fully to adapt to smaller and independent participants *per se*: it is even harder to see how it will - unless changed - adapt to more non-traditional industry participants;
- It is essential to find non-traditional ways to engage smaller and independent participants – whether with traditional business models or non-traditional – to enable the industry effectively to challenge “the way things are done” and to innovate around solutions that work for all participants;
- We assume that similar constraints to those of newer and smaller players apply to consumer representatives and believe more could be done to ensure that their views and concerns are sought early in any change process, or at least those where there are consumer impacts, whether direct or indirect; and
- That code governance, as your list of non-exhaustive changes indicates - should be seen within the overall context of policy and framework changes, all of which make calls on industry participants to manage change, separately and cumulatively.

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?

The Significant Code Review process

We have only been actively involved in the Electricity Balancing Significant Code Review (**EBSCR**) and cannot therefore comment more generally on the success or otherwise of the Significant Code Review (**SCR**) process. Based on the attempts prior to the launch of the EBSCR to secure changes to imbalance arrangements and cash out, it is fair to say that the EBSCR did enable Ofgem to propose and develop, subject to consultation, and then effectively to “manage”, complex changes into the industry.

We note that Ofgem did limit the earlier wider scope of the EBSCR, hiving off certain aspects into the Future Trading Arrangements workstream. As we noted in our CMA response, it may be worth considering whether complex change in terms of policy proposals or programmes is made more so by too wide a scope, recognizing the interdependency of many areas and the impact of change (we consider issues arising from cross-code change below). Smaller and independent suppliers, given the likely smaller scale of their regulatory or code teams (in many cases, the same people) struggle to

participate across policies or programmes with many strands, each of which are themselves fairly complex, where these demand different skills, experience and disciplines. This is not to suggest that the focus of scale change should be artificially narrowed, just that the challenges for all participants in responding to consultations, engaging with workgroups and otherwise actively participating is greater in such programmes.

For the EBSCR, we did have concerns as to whether or not industry participants could actually have influenced the outcomes. One key theme of the cashout and related changes, as emerged clearly in consultation responses to the workgroup process, was the disproportionate impact on smaller and independent suppliers. These participants were less likely actively to participate in the policy proposals being consulted on as part of the SCR, and by the time the impacts were perceived, it was arguably too late to influence the direction of travel around PAR levels and related changes.

We also had some concerns regarding the involvement of independent suppliers in the early stages of the EBSCR. We are not best placed to comment in any detail on the efforts made to ensure independents were aware of the EBSCR and the potential impacts. We can say that notwithstanding the information provided at the time, many smaller and independent suppliers had not engaged as actively as they would have wanted in the earlier stages of policy development. By the time we became aware of the potential impact of the changes, for example, and as already noted, it was too late to influence the overall policy outcomes: our involvement initially focused on a specific element of the changes (namely, the separation of single cash out from the reduction in PAR) rather than the underlying principles, which had already been determined.

A further area where the disparities of resource between more established players and newer entrants were reflected was the underlying modelling for the proposals. Ofgem clearly invested significant resource into their economic models, which in many respects drove the balancing changes that were implemented. Many market participants (possibly even including the larger market participants) did not have the resource or perhaps the expertise to develop other models or critique the Ofgem economic models, which outcome should be of concern to all market participants.

In light of this, it may be useful to consider a more open form of modelling, which makes available the model itself alongside discussions as to useful data to be input (if publicly available) or to manage an arms-length arrangement with an appropriate third party where not available. The modelling process would benefit from input from a range of players inputting their assumptions and scenarios early on, which could then, in an appropriate form, be made available to all participants. We recognize that this adds to the potential participation burden on all players but do think that something along these lines could be made to work with different levels of participation.

Ofgem's approach to smaller and independent suppliers, along with DECC, through the Challenger Business initiative is a good start in raising these issues with smaller participants, and providing a forum for discussion. However, this initiative is perhaps not ideal for discussion of more detailed industry changes or programmes. Also, whilst it considered e.g cashout, once it hit smaller players' radars, this does not address the early engagement point made above. Ofgem's engagement with smaller and independent

suppliers is being, and will need to be, developed beyond this. Here, we note that this constituency includes many different businesses, with different aims and objectives, and concerns. A group meeting cannot elicit full discussion around these. We do think there needs to be a wider review of engagement with the changing shape of the industry, and commend the start being made in this area.

Finally, we included a case study on P305 in our response to the CMA's updated issues statement and would refer to that for specific points around the workgroup process, the handling of consultation responses and the role of the BSC Panel.²

Self-governance

As we have to date only limited active involvement in each and even less so across all the codes, we are not in a position to comment in detail on the self-governance arrangements across the different codes and whether in all cases the criteria remain appropriate.

We support a review of the self-governance criteria on the basis that as with other areas, it may be that the criteria made certain assumptions as to the structure of the industry or the materiality of impact on competition that given the current and fast developing market landscape and the entry of newer players, including those with non-traditional business models, that now need overhauling. This exercise alone will help to raise the profile of this type of code change with participants.

Charging Methodology Governance

We have not to date actively engaged in the charging methodology process as a result of which, we cannot make any observations based on our experience. In general terms, First Utility has concerns as to the accessibility of the arrangements for smaller and newer industry participants around charging methodologies. We agree that these methodologies are usefully included in industry codes. This allows participants – at least in principle - to raise changes. They are however included in codes which are arguably more technically distant from the suppliers, whose customers ultimately cover the charges being addressed. This is of concern generally as it is unlikely that many smaller and newer industry participants have the bandwidth actively to engage in the consultations on the charge controls themselves. This means that their views were not fed into the development process for charges. It also means that they are at a disadvantage for any subsequent developments, including around the charging methodologies.

We accept that such participants could in principle join the relevant working groups for each of the CUSC and DCUSA and join the quarterly calls covering some of the charging issues. However, the fact remains that these participants are not actively and continuously able to do so. This has most recently been borne out by issues arising from the process for recovery of the December 2013 customer rebates by the Distribution Network Operators. Without going into any detail, the approach to recovery by some DNOs came as a surprise to a number of independent and smaller suppliers, from which we infer that whilst information was made available in the usual way, these means were simply not effective to

² Ibid., at pp. 61-66.

give actual notice to those suppliers. For this specific reason and reflecting our and potentially others' general concerns, efforts actively to engage smaller participants need to be revisited and we welcome the chance to work with Ofgem, code administrators and other industry participants to improve this key area.

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?

We agree that there is a need to consider further reforms to industry code governance arrangements in order to improve the engagement of and input from smaller and independent market participants.

Overall, the disparity of levels of resource between the integrated incumbents and independent market participants is widely acknowledged as a significant reason why independents find it difficult to keep abreast of, and engage in, consultations for licence condition modifications and code modifications. Furthermore, independents do not have the same capacity to contribute to workgroups, expert groups and participate by other means. For those participants who cannot participate in the consultations for change, their views may not be provided at all.

As a result, governance bodies and working/expert groups may not gain the benefit of independents' views and experiences or a chance to understand and work through their concerns. In this context, it must be recognised that such commitments can only be continuously met by the incumbents, and that the majority of individual participants will by default be provided by them. This is not to say of course that their participation is not essential to the process of industry governance and change management.

We set out some initial thoughts on how all market participants in general and smaller participants in particular can be assisted in these industry processes in the next section. However, some specific points may be useful:

- a) On a very practical note, currently it is very difficult to engage with modification workgroups over the telephone due to poor teleconferencing facilities at most organizations involved in change processes. Meeting attendance becomes almost essential and puts smaller companies at a significant disadvantage.
- b) A centralized modification management system for all codes, used by all code administrators may help. This would allow participant codes managers to track all code modifications from one source and ensure nothing is missed. It does not seem to us efficient that each code administrator has their own version of a modification management system. Such a system would be particularly useful for smaller suppliers, but would also likely reduce costs for all market participants.
- c) Are there faster and easier ways to get smaller participant views than written responses to consultations? We think that there are and these may vary between participants. They could include a short call to each participant to canvass views, shorter Q&A type prompts seeking views or asking for yes/no responses on impact and an appropriate

set of other issues (which could help to filter and tailor future engagement, provided any views on engagement are revisited) or a per quarter meeting covering all ongoing changes, with video conference facilities for those who cannot attend.

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 set out our thoughts on potential changes in our CMA response in relation to the updated theory of harm five and our views on possible solutions at paragraph 5.18. We set out our thoughts again below for ease of reference:

- a) Reconstituting the Cross-Codes Forum, with wider and more active marketing of it to encourage greater participation (whether in person, by phone, etc.). Whilst there are issues and sensitivities around scope of work for each code body, it would be possible to establish a joint code bodies working arrangement, building on current cooperation, to support this forum.

The Forum could have as one of its stated aims to facilitate smaller participant engagement in all codes. This could manifest in the provision of information, teach-ins and specific assistance, pushing information to such participants in an appropriate form, and also pulling information from them for inclusion in ongoing modification processes. This could include, for example, for workgroups without any smaller participant representation, putting a questionnaire or giving homework to such participants so their perspective can be obtained. Whilst the various consultation stages do allow this, the aim here would be to inject such input earlier in the process;

- b) Cross-code change pipeline management, which could be done through the Cross Code Forum or through a specifically constituted Change Body. The aim would be to canvass industry and policy-maker views on possible matters for change; change suggestions could be categorized into non-material, cross-code impacting, material, major or other appropriate categories, and the amount of change in each category assessed and grouped. This would facilitate pro-actively managing cross-code changes and the potential clash of any major changes whilst also helping to feed in smaller participant views earlier in the process.
- c) It is also worth considering the use of smaller market participant representatives in workgroups and adjusted voting. For example, if representing other smaller suppliers, a representative can vote on their behalf in addition to their own or, where relevant, have any votes weighted or representation otherwise pro-rated by total market share of those being represented.

There is significant difference across the codes regarding the weighting of votes. For example, the MRA and SPAA votes are weighted based on market share. It is therefore not surprising that few smaller suppliers have engaged with these groups. The UNC and BSC voting mechanisms however are not weighted by market-share and have had more independent shipper / supplier involvement. This may of course be due to other considerations, such as perceptions of business utility or greater knowledge of and

experience in the issues. Notwithstanding, in our view there is no reason for there to be any difference in the voting mechanisms across these codes.

We look forward to working with you and your team on this key review and ot discussing our thoughts further with you. If in the meantime, you would like any further information or have any questions on this response or related matter, please do let me know.

Yours sincerely

[sent by email]

Natasha Hobday
Head of Policy and Regulation
natasha.hobday@first-utility.com