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Dear Maxine,

### **Further review of industry code governance**

Thank you for the opportunity to respond to Ofgem's further review of industry code governance.

We are concerned that the timing of this review may not sit easily with the timing of the CMA market investigation which, as Ofgem notes, is addressing very similar issues. The CMA will be publishing its provisional findings on Theory of Harm 5 in early July and confirming its decision on remedies by December 2015. If Ofgem is to consult on more detailed proposals for change in late summer 2015, any such proposals could be overtaken by the final recommendations of the CMA. It is essential that this further review is carefully coordinated with the work of the CMA and in accordance with any principles they may lay down.

ScottishPower supports an open code governance framework which facilitates full industry participation in the development and implementation of code changes. This is particularly important as we face the challenges of the increasing proportion of intermittent and embedded generation on the system, the impact of the roll-out of smart meters on settlement systems and the implementation of the European Network Codes in electricity and gas.

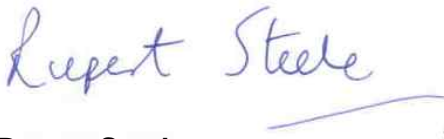
Our detailed responses to the questions raised in the consultation are set out in the annex to this letter; we would like to highlight the following points:

- With the three Significant Code Reviews (SCRs) to date, we have not observed any shortcomings that support proposals to allow Ofgem to write code modifications and specify their timescales. All three SCRs have been subject to prolonged delay at the Ofgem led pre-modification phase which would not be addressed by Ofgem's proposals.
- Where the Critical Friend (CF) role of code administrators has been established we believe it is functioning as intended and being used by smaller parties across the codes in question. We would support initiatives to improve performance of the CFs and we believe sharing best practice amongst code administrators would facilitate this. We also think trade associations can be an important route for smaller parties to engage in code governance.

- More generally we agree with Ofgem that closer alignment of governance arrangements across codes together with independent panel chairs and members should increase transparency, remove incumbency advantage and thus increase engagement of smaller parties.
- With regards to charging methodologies, we have concerns that Ofgem's proposals to package all modification proposals into two windows each year may produce a highly concentrated and potentially unmanageable workload at each window, with the consequence of less robust decision making by the relevant code panels.

Please contact me if you have any questions on any of the matters raised in our response.

Yours sincerely,



**Rupert Steele**  
Director of Regulation

**CONSULTATION ON A FURTHER REVIEW OF INDUSTRY CODE GOVERNANCE  
– SCOTTISHPOWER RESPONSE**

- 1. Do you consider the governance changes introduced under CGR and CGR 2 has been effective in improving the code governance arrangements? In particular considering the efficiency and effectiveness of code change, the ability of large scale reform to be implemented, and the accessibility of the arrangements for smaller/newer industry participants and consumer representatives?**

ScottishPower believes that the changes introduced in 2010 and 2013 have had varied degrees of effectiveness in improving the code governance arrangements.

**Significant Code Review (SCR)**

The SCR process has had some success. The three instances in which the process has been used by the Authority to date (Gas Security of Supply, Review of Electricity Transmission Charging (TransmiT) and Electricity Balancing) have not been cross-code issues but have impacted a single code in each case. However, the issues being addressed in each SCR were of such scope that we believe it was appropriate to use a pre-modification process, such as an SCR.

We understand Ofgem is intending to utilise the SCR process to implement the next day switching initiative.<sup>1</sup> This would involve cross code modifications and provide a useful test of the effectiveness of SCR process. As with the previous SCRs, we would expect the Impact Assessment to show a robust consumer benefit case supporting the implementation of such changes via the SCR route, as we believe this will facilitate buy in from stakeholders.

Our key concern from the three SCRs to date is around the time taken with the SCR process: in the case of gas security 44 months and in the case of electricity balancing 21 months, before the Authority decided whether to make a direction for code change. These timescales contrast with the stated intention that the Ofgem-led phase would take no longer than 12 months in most cases. Such prolonged pre-modification phases could create uncertainty for industry participants especially where complex and substantial changes are involved.

Once the Authority has issued a direction, industry appears to have processed the resultant modifications with reasonable efficiency (13 months for TransmiT and 10 months for electricity balancing) despite the complex issues and distributional impacts involved. In the case of TransmiT, the Authority then took a further 13 months and two rounds of consultation to reach a decision. The modification (which is currently subject to Judicial Review) has a revised implementation date of April 2016, which is four years behind the original implementation date targeted at the commencement of the SCR.<sup>2</sup>

There may be scope for improvement in the industry-led phase of the SCR process if, following the conclusion of the Ofgem-led phase of the SCR, Ofgem considered carefully how much further development of the proposals is required when drafting their direction to the licensee. If the solutions have been clearly identified, then a relatively narrow direction

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<sup>1</sup> <https://www.ofgem.gov.uk/ofgem-publications/93228/tom-and-delivery-final-pdf> Section 1.05.

<sup>2</sup> Project TransmiT: electricity transmission charging Significant Code Review launch statement <https://www.ofgem.gov.uk/ofgem-publications/54149/110707final-launch-scr-statement.pdf>

will facilitate a more efficient industry development phase; if further development of solutions is required by industry then a wider direction and longer timetable may be appropriate.

### **Self-governance**

The self-governance arrangements introduced into six of the industry codes have largely been successful. However, we would suggest that the various code panels may have been unduly conservative in determining which modifications would qualify for the self-governance and fast-track processes due to an unnecessarily strict interpretation of the Self-Governance Criteria contained within the codes. Parties' right to challenge a panel decision to follow the self-governance route would appear to provide adequate safeguards to ensure the most appropriate level of modification development and consultation is followed, and we think panels should attempt to make greater use of the self-governance process.

### **Code Administration**

The formalisation of the Code Administration Principles and, in particular, the development of the role of "critical friend" to assist parties with the development of modifications would appear to be functioning as intended. As part of their further review, we would suggest that Ofgem look at the performance of the individual code administrators with a view to identifying best practice and extending this across all of the codes. The key performance indicators published by code administrators may be a suitable starting point for this process.

The appointment of independent panel chairs to the BSC, CUSC and UNC provides assurance of impartiality to parties to the codes and should be extended to cover other codes. We do not believe that cost should be an issue as the costs associated with provision of an independent chair are modest and similar sums would otherwise have to be borne by companies providing staff to fulfil the chairman's role (which costs, in the case of network companies, may be recoverable through allowed revenues).

### **Governance of charging methodologies**

We strongly supported bringing the charging methodologies under the general code governance arrangements and we believe that this has prompted a greater level of industry involvement in the charging arrangements.

## **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?**

### **Significant Code Reviews**

Ofgem is inviting views on whether it should have additional powers in respect of SCRs to draft code modifications itself and specify timetables in our response to Question 1 we observed that the main delay to SCR timescales has been the Ofgem led pre-modification phase which would not be addressed by Ofgem's proposals. Unless there is evidence that licensees have been failing to raise modifications in accordance with the directions issued by Ofgem, we see no reason to extend the power to allow Ofgem to draft code modifications itself.

Modification timetables are generally set by a code panels based on an assessment of the complexity of the issue and the level of analysis required but in line with a standard timetable (eg in the case of CUSC, 4 months). Approval by Ofgem is usually required if the standard timetable is to be exceeded. Given that Ofgem already has an effective power of veto over

extensions to modification timetables, we see little benefit in giving the Authority a power to specify timetables.

In addition, there may be issues with the Authority's perceived impartiality when deciding whether to approve a modification that it has drafted, set the timetable for and acted as owner of throughout.

None of the three SCR processes conducted to date have involved cross-code issues; therefore, it is probably too soon to say that the SCR process is deficient in this respect.

## **Self-governance**

As outlined in our response to Question 1, we consider that the various Code Panels may have been unduly conservative in determining which modifications would qualify for the self-governance and fast-track processes due to an unnecessarily strict interpretation of the guidelines issued by Ofgem. Parties' right to challenge a Panel decision to follow the self-governance route would appear to provide adequate safeguards to ensure the most appropriate level of modification development and consultation is followed and therefore Panels should be encouraged to make greater use of the self-governance process.

## **Code Administration**

### *Greater use of critical friend role and increasing engagement with smaller parties*

We broadly agree that greater use should be made of the critical friend role to further support smaller parties. This approach was adopted by the BSC and, anecdotally at least, appears to have met with some success, with a significant share of modifications being raised by smaller parties. However, it is not clear the extent to which this is attributable to the CACoP, as we also note that of the 15 CUSC modifications raised by parties other than National Grid in the six years from 2009 to 2014, 11 were raised by parties other than the larger generators and suppliers.

More generally we are unclear as to whether perceived barriers to entry by smaller parties are a consequence of the code change process itself or the wider market arrangements and codes (or a combination of the two). While the code arrangements are undoubtedly complex, the role of the Code Administrator as "critical friend" enables any party, including smaller parties, to seek guidance when seeking to promote change.

Code Administrators have produced Code Summaries which provide a high level overview of the individual codes with which licensees are obliged to comply.<sup>3</sup> ScottishPower would support greater promotion of these guides to prospective and new entrants to the market.

ScottishPower sees an enhanced role for the various trade associations to represent the views of smaller parties and provide representation in the change process through cost-sharing.

### *Coordination across codes*

We agree that there should be better coordination of change across codes and that this will be particularly necessary during the implementation of the European Network Codes. As noted by Ofgem, Code Administrator Code of Practice (CACoP) Principle 13 aims to achieve this through promoting early identification of cross-code issue and coordination of change

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<sup>3</sup> <http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/Code-Summaries/>

process and implementation timetables with a view to presenting related code changes to the Authority as a single package.<sup>4</sup> We believe that introduction of Principle 13 should help facilitate this coordination; something that is likely to become more pressing once the SEC becomes fully operational, and the impacts of change more frequently span market sectors.

The Joint European Stakeholder Group, chaired by DECC and Ofgem, will play a key role in the implementation of European Network codes in GB through informing and engaging industry in the process and facilitating coordination between the various GB codes. A workgroup is already considering the impact of the Requirements for Generators Network Code upon the Grid and Distribution Codes and similar workgroups will begin considering the impacts of the HDCV and Demand Connection Codes shortly.

One area that may not be captured under the current arrangements is the alignment of development in gas and electricity. This is particularly important in energy retail where many participants including new entrants have dual fuel portfolios. It is important that wherever possible, existing processes and change proposals allow parties to consolidate arrangements across gas and electricity to the benefit of consumers by lowering costs and facilitating greater competition.

#### *Prioritisation of code changes*

At present there has been no explicit prioritisation of code changes although the transmission licensee as originator of a significant proportion of electricity modifications, eg CUSC, Grid Code etc, may be prioritising issues on an informal basis. This may be as a result of discussions in industry fora such as the Transmission Charging Modification Forum and its equivalent under other codes to determine industry priorities.

Should the volume of industry change increase to the extent that it is deemed necessary to introduce formal prioritisation of change, this would raise difficult questions as to who undertakes the prioritisation and for how long modifications that are deemed to be of lower priority would be delayed. This could create a perception of unfair treatment in the minds of the promoters of such modifications.

One approach to this might be to set clearly defined objective rules to govern prioritisation, though this may have difficulties in coping with the unexpected. There should be limits to ensure that lower priority modifications are nevertheless considered within a reasonable period. We believe that any prioritisation should be managed by the Code panels in conjunction with the Code Administrators and subject to approval by the Authority.

#### *Better consideration of consumer impacts*

At present the applicable code objectives are largely designed to facilitate efficient operation of the energy delivery systems and to facilitate competition, which in turn should have a beneficial impact upon consumers. The Authority has a wider set of objectives in deciding on code modifications, including the impact upon consumers, and we consider that the most appropriate process for determining the impact on consumers, where considered material, should be within a regulatory impact assessment conducted by the Authority.

The Authority will be able to perform a wider assessment of the costs and benefits associated with change and should be able to draw upon analysis, expertise and resources not always available to working groups. We also recommend that consumer representatives get involved earlier in the process. By attending working group meetings they might help to

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<sup>4</sup> [https://www.elexon.co.uk/wp-content/uploads/2014/10/12\\_236\\_07\\_CACoP\\_Principle\\_13\\_PUBLIC.pdf](https://www.elexon.co.uk/wp-content/uploads/2014/10/12_236_07_CACoP_Principle_13_PUBLIC.pdf)

mitigate consumer impacts before a modification report is presented to the Panel for decision.

Based on our experience we believe there may be merit in assessing the scope for improvements in the supporting analysis for UNC modifications (against the code objectives) - and the role of Xoserve in assisting the development of such modifications relative to the quality of analysis produced for BSC and CUSC modifications.

#### *Code panel membership*

ScottishPower supports an open election process for code panels such as that applied in the electricity market through the BSC and CUSC. This allows all parties to seek representation on an equal basis. Further, all panel members should be required to act independently and to provide assurance from their employers that they are free to do so (eg CUSC 8.3.4). This would not only promote more robust decision making, it would help remove any perception of incumbency advantage by focusing that decision making on the code objectives themselves and away from the commercial interests of individual parties. Removing any perceived incumbency bias should improve the engagement of smaller parties and new entrants in the code governance process.

We would therefore support the adoption of independent panels and open election of members to other codes. For example, we understand these features are being considered for the Grid Code and independence requirements are being considered as part of the development of the new Performance Assurance regime under the UNC. We would support the adoption of both of these aspects across other Codes.

We agree that closer alignment of the governance processes across codes may facilitate participation by smaller parties.

#### **Charging methodology governance**

ScottishPower believes that in some codes, such as CUSC, effective fora exist for the development of code changes prior to the commencement of a formal modification process and that this could be extended to other codes. However, we have concerns over Ofgem's proposals for packaging of modifications or the introduction of "modification windows", as this may lead to concentration of effort into particular time periods with resource implications for working groups and code panels. Similarly, Ofgem would need to be resourced to ensure that modification packages and windows did not result in a backlog of modifications from multiple codes awaiting approval decisions by the Authority.

### **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 not identified any additional areas for reform beyond the original CGR/CGR2 changes.

We think there may be merit in considering extending certain aspects of the open governance reforms introduced by the CGRs to other industry codes, notably the Grid and Distribution Codes. These codes are a key part of the technical and contractual arrangements that have a commercial impact on electricity market participants. All parties to these codes should therefore have the ability to propose and comment on modifications to the codes. There may also be merit in looking at the constitution and function of the Grid and Distribution Code panels to align them more closely with codes that have been more

fully subject to the CGR reforms. An important consideration here is ensuring that the code panels in question are able to progress all proposed modifications through the required development to a point at which the panel can decide on the proposals against the code objectives. For the same reasons, similar consideration could be also extended to the transmission security standards (GB SQSS), which *inter alia* govern connections to the transmission networks.

ScottishPower  
26 June 2015