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Dear Maxine,

**Further review of industry code governance**

We welcome Ofgem's letter of 15 May 2015, which seeks to understand the need and appetite for further review of industry code governance. This response reflects the view of SSE plc and is submitted on behalf of Scottish and Southern Energy Power Distribution, Scottish Hydro Electric Transmission plc, SSE Energy Supply Ltd, Southern Electric Gas Ltd and SSE's licensed generation businesses.

Whilst the existing system of codes is generally effective, we believe there are aspects of the codes system that have become clumsy over the years. This is almost inevitable where there are a number of codes, modified and governed in different ways.

Given this, and the coming into being in the short to medium term of the European Network Codes (ENC), we believe there is now a real opportunity to conduct a full-scale review of the GB industry codes system. Unlike licences, the industry codes system has never been subject to a complete review. A rigorous review would identify options to simplify, consolidate and streamline the industry codes, which would ultimately be of significant longer-term benefit to all market participants and, as a consequence, a benefit to consumers.

In taking forward this review, we believe the ideal approach would be to place the existing GB industry codes, which focus on upstream operations, into the three groupings used for the ENC, namely (i) connection codes[1]; (ii) market codes[2]; and (iii) operational codes[3]. This would consolidate both the existing and future upstream code requirements (covering generation and networks) into just three new GB codes for electricity. A further upstream code would cover gas. For retail operations, we believe there is the potential for a cross-fuel market code covering customer facing activities (e.g. metering). This code would sit alongside the Data

[1] Requirements for Generators, Demand Connection Code and HVDC Connections
[2] Capacity Allocation and Congestion Management, Forward Capacity Allocation and Electricity Balancing
[3] Operational Security, Operational Planning and Scheduling, Load Frequency Control and Reserves

Communications Company (DCC) Service Provider arrangements within the Smart Energy Code (SEC). The two dual-fuel retail codes could be characterised as one covering interactions between service providers and one covering processes that include interactions with customers.

If these changes (presented in Figure 1 below) were to be implemented, GB compliance with EU law could be expedited and maintained whilst also reducing the existing overlap and duplication of similar elements between industry codes (e.g. obligations relating to credit and payments).

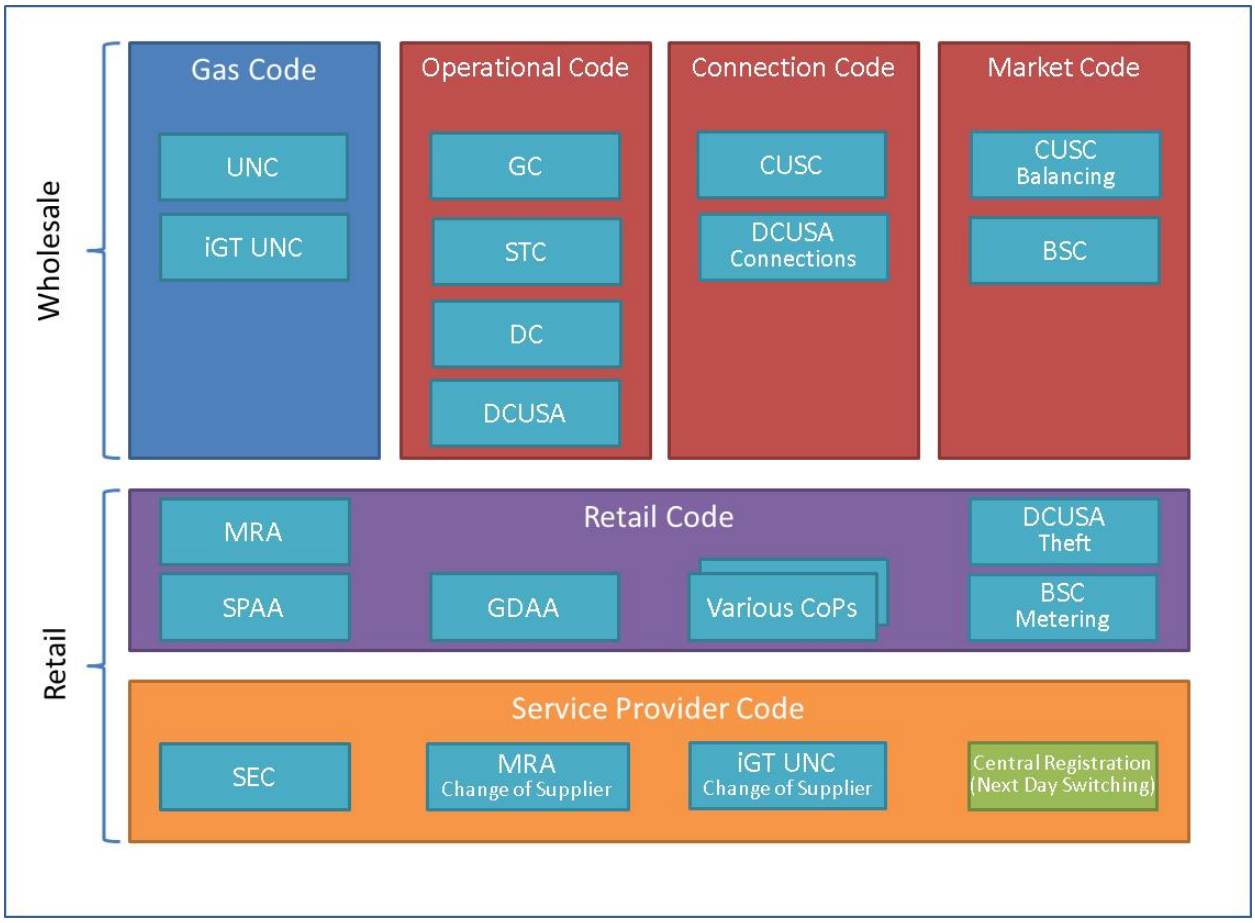


**Figure 1 Proposed consolidation of industry codes; note that only significant transfers of requirements shown.**

As is the case at the moment, each of these six codes would continue to have its own administrator and panel. Going forward, we believe there would be merit in the code panels operating as a management board for that code, convening a change board to consider modifications as appropriate. This approach - which is currently employed for the SEC, MRA and SPAA - has the benefit that more senior people with a greater appreciation of wider policy objectives can prioritise the business of each code, whilst relevant experts are able to concentrate on assessing the technical aspects of modification proposals. Re-organising the existing national structure to mirror that of the ENCs would also reduce the likelihood of

duplication across the industry codes, and therefore the scope for divergence over time as further modifications are brought forward.

SSE does not believe that such a consolidation of existing industry codes will, in itself, deliver the required improvements to code governance which Ofgem and others have called for. However, SSE strongly believes that the consolidation and streamlining of codes described above is a necessary step to facilitate the more efficient delivery of future changes. SSE believes that the critical objective of delivering a greater degree of cross industry and cross code coordination in implementing strategic industry reforms could be achieved by establishing an overarching, strategic body that sits above all of the industry codes.

Whilst we are still developing our thinking in this area we are mindful of the structures used elsewhere. Notably, the Australian Energy Market Commission develops strategic priorities in conjunction with consumer, industry and other interested stakeholders and ensures that the development of the Australian energy market is focused, coordinated and appropriately resourced. SSE believes that establishing a similar strategic body to oversee the GB codes could deliver real efficiency benefits when prioritising and delivering coordinated industry change. Whilst the division of energy policy in Australia between state and federal governments has occasionally led to conflicts or delays in implementation of changes, SSE believes that such a structure would be very effective in the GB energy market.

A further role for a strategic body could be in signposting all parties to the sections of the industry codes which are relevant to them; this service would be particularly welcomed by smaller parties and potential new entrants and could be provided at relatively low cost through an automated web-service.

SSE believes that the final piece of this revised structure is the adoption of a common approach to governance across the industry codes. We believe that all the codes would benefit from the open governance arrangements, as established by Ofgem via the two previous Code Governance Reviews, which already apply to the Balancing and Settlement Code (BSC), the Distribution Connection and Use of System Agreement (DCUSA) and the Connections Use of System Code (CUSC).

We are keen that these changes bring about greater engagement from all stakeholders in the industry codes. However, given that the codes govern a multitude of technical and specific processes affecting all routine interactions between parties involved in all parts of the value chain, we also recognise that the codes are necessarily complex. Users of the codes need to be mindful of this and to manage their expectations in terms of what rationalisation and simplification of the codes will look like.

It is also worth noting the resource constraints faced by all market participants when considering important code modification proposals. The recent and significant change DCUSA Change Proposal 178 (to move from a forty day notice period to a fifteen month notice period in relation to use of system charges) attracted less engagement than may have been expected despite this change having a fundamental impact on DNOs and suppliers (for example, two of the six largest suppliers did not vote on this proposal).

We hope this and the attached detail provides useful input to the process. As indicated above, our thinking in this area is still developing; we will be in touch to arrange a meeting with you in due course, as we are keen to explore and discuss our ideas further as Ofgem's own thinking in this area develops.

Yours sincerely,

(by email)

Adam Carden

**Head of Industry Codes**

**Annex 1 – SSE response to consultation on further review of industry code governance**

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?**

**Significant Code Reviews (SCRs)**

SSE recognises that current delays in this process can be frustrating for market participants and Ofgem alike. SSE therefore supports changes that could expedite the process whilst retaining an appropriate level of scrutiny from technical experts to ensure that potentially adverse unintended consequences are avoided. However, we recognise that some delays may be unavoidable due to the nature of the proposed change: more contentious modifications will involve more challenges from parties and be more time consuming, whilst modifications which interact with other industry change may be reliant on those programmes being delivered as a pre-requisite.

SSE is keen that SCRs should continue to be assessed on a case by case basis, as there are a number of factors that can affect the timescales for completion.

SSE considers that there are benefits to be gained by taking a more collaborative approach to engagement, prior to giving notice of the intention to undertake an SCR. A recent example was the use of the Change of Supplier Expert Group (COSEG), to evaluate the proposals for potential industry changes and further define the scope of work under consideration. This has crystallised into the policy proposals for fast and reliable switching with a programme of work intended for delivery to consumers by 2019.

Ofgem has set out a high level plan with phasing, for the fast and reliable switching programme, and communicated this to the industry[4]. Further development of the programme plan for implementing these policy proposals will take place through the remainder of 2015. We welcome the approach that is proposed and the information provided on the objective of each phase. We support the setting of expectations, from the commencement of blue print development through to delivery, with a firm implementation timescale.

We would further support the directing of a coordinated modification timetable by Ofgem, as we believe providing this clarity and direction would enable the industry to be more effective in their delivery of these changes. This would also facilitate the cross code coordination by Code Administrators, enabling them to define an overall plan that is efficiently resourced and supports delivery of effective Modification processes.

For the Industry-led stage, SSE believes there is merit in undertaking a detailed assessment at the outset to establish the required tasks and their anticipated duration, together with the identification of risks introduced by shortened, or extended, timescales. SSE would also recommend that there are regular reviews where collaboratively we could determine if the tasks or duration needs to change. With a clear direction and focus provided by Ofgem from

[4] https://www.ofgem.gov.uk/ofgem-publications/93224/fastandreliableswitchingdecisionfinal.pdf

the outset, coupled with progress reviews, there would be increased flexibility to refine the approach, potentially identify better ways of working and increase the likelihood of a successful outcome.

From the experience gained in discussing changes in industry forums, SSE considers that there can be a knowledge gap where industry representatives are unclear regarding engagement with Ofgem during the industry stages of change. SSE believes that defining the terms of engagement for seeking guidance and direction from Ofgem, would strengthen focus and benefit timescales.

**Self Governance**

SSE is fully supportive of the self governance arrangements for industry codes and sees it as an effective mechanism to facilitate change. Whilst the initial impact assessment overestimated the proportion of changes delivered by this means, SSE agrees with Ofgem's assessment that the delivery of 30% of code changes under these arrangements is a significant benefit. Given the variations in the use of self governance mechanisms between different codes, SSE sees merit in exploring the figures for each code further. Such an evaluation may help to identify opportunities for greater use to be made of this approach.

**Code Administration**

SSE notes the concerns set out in Section 4 of Annex 1, and the areas under consideration for potential further reforms.

<u>Strategic perspective</u>

There is merit in considering the strategic advisory groups set up by Ofgem in the past to support specific industry projects, for example:

- the Change Overview Board in gas (looking at the longer term change horizon in an attempt to better manage change to industry systems);
- the Future Trading Arrangements Forum (addressing the challenges of current trading arrangements remaining fit for purpose and adaptable to forthcoming policy, regulatory and market changes); and
- the Smarter Markets Coordination Group (to provide strategic input into the Smarter Markets programme and to inform its evolution).

Whilst these groups have taken an advisory role there is merit in considering whether an independent group sitting above the existing industry code panel arrangements could be formalised with a specific remit to develop a strategic roadmap for the development of the codes. An ability to take a broader view across the industry may also be helpful to resolve the concerns that change is fragmented and disjointed, where there are significant issues. Such a function would need clear terms of reference to define the scope and vires of their activities and those of the code panels but a requirement for code panels to consider modifications in the context of the strategic roadmap alongside the existing relevant objectives could be considered. We note in other markets this structure has been very effective, in particular the Australian Energy Market Commission and the former UK Payments Council have delivered a degree of strategic direction and certainty to their respective markets.

Panels and work groups

Due consideration should be given to the appropriate make-up of code panels to keep step with potential simplification. A key factor in this regard will be in ensuring that panels are able to review and assess all modification proposals affecting any consolidated codes properly and in a timely manner.

We note the reference to the modification panels and the potential benefit of extending independent panel requirements to other codes. The panels include representatives from the larger energy firms and the network operators, as well as other generators, other suppliers and independent experts with no affiliations to industry players (see **Annex 2** – **Energy Code Panels**). SSE believes that it is a mistake to focus discussion of resourcing issues on the degree to which smaller participants are represented on work groups and panels. This represents a significant resource constraint for larger participants as well and, for that reason, the independent panel approach is perhaps the most efficient means of addressing concerns.

Additionally, modification panels are generally attended by an Ofgem representative and other industry representatives are entitled to attend Panel meetings as an observer, by agreement with the Panel Chair.

The principles set out in the Code Administration Code of Practice (CACoP) are still applicable to work group processes, whereby our experience of these is that a Code Administrator will be in attendance. Under that code, the Code Administrators are obliged to ensure that unsubstantiated assumptions or assertions do not go unchallenged, all arguments for and against a modification are adequately discussed and previous discussions or decisions that may be relevant to a modification are highlighted.

In addition, Code Administrators have a duty to raise modification issues that are relevant to small market participants who are not otherwise represented at appropriate industry meetings. The interests of smaller suppliers and independent generators are thus adequately safeguarded in the code modification process even in their absence.

In January 2014, as part of Ofgem's Code Governance Review, a requirement was introduced for Code Administrators to act as a 'critical friend' for small market participants and under-represented parties. This role involves providing education on its code modification process, encouraging participation in the code modification process, helping users to develop modifications and ensuring that smaller market participants' views are not stifled.

SSE supports the engagement of all relevant parties in the assessment of changes. The identification of consumer impacts must be fully assessed to ensure it is an accurate reflection and well informed. Where it has been identified that a modification has a material consumer impact, it is essential that consumer representation is fully engaged with the workgroups and solution development from the outset.

Resources

Another important factor relating to resource availability for the assessment of code modifications is the increasing rate and scale of industry change. Many of the changes require significant IT developments, which put considerable pressure on systems and resources. Not only does this create a constraint in terms of the scope for further changes to be introduced at all, it may also negatively impact the capacity for affected parties to fully consider the range of potential system and process impact of modifications currently at the assessment stage.

However, we are not supportive of 'change windows', which would limit the ability to bring about changes when they are needed. Moreover, we believe change application windows would make it worse for stakeholders: this would concentrate the resource and system changes needed to the point where it could become untenable.

**Governance of charging methodologies**

SSE agrees that there are benefits of including the charging methodologies within the relevant codes.

SSE agrees that the charging methodology change processes across the relevant codes would benefit from a more managed process to ensure that panel members are more aware of the actions of the other panels. This would help to mitigate the risk that panels work at cross purposes. As discussed elsewhere in this response, SSE believes that this could best be achieved by the creation of a high level strategic board to consider policy priorities and to coordinate the development and implementation of strategic change (such as the roll-out of smart meters). This approach would also prove useful to Ofgem in helping to ensure that its own Networks and Retail teams are fully aware of each others' actions and are acting on compatible instructions.

SSE also agrees that each industry code would benefit from formally considering within their change proposal consultations the questions:

- How does the change proposal impact on consumers and on other parts of the industry?
- How do consumers benefit from the change proposal?

SSE regards the existing pre-modification processes for each of the charging forums as effective in ensuring that proposals are workable prior to submission for detailed consideration. However, improvements could be made in terms of communication, as this would help to address the concerns of large customers, as discussed below.

<u>Charging forums</u>

SSE agrees that charging forums should be the main area for discussion of issues related to charging methodologies – indeed, SSE's non-network businesses have found the forums to be very helpful in this regard. Ofgem notes in the open letter that some users have expressed concerns at the approach taken by network operators which has negatively impacted users' willingness to use charging forums for further development before formally raising charging changes. SSE is aware that two distinct groups have voiced such concerns – large non-domestic customers and consultants.

*Large I&C customers*

Large customers can be frustrated by the technical nature of the subject matter discussed at charging forums and may regard sending representatives to all relevant meetings as too big a drain on resources for relatively little gain. Measures which could help address such barriers would include requiring charging forums to maintain a public website which is updated regularly to provide clear notification of meeting dates and to make available to all interested parties the minutes of previous meetings (rather than restricting circulation to meeting attendees only).

*Consultants*

Consultants may experience problems when raising change requests due to the requirements of industry codes that parties must show they have a financial interest in a change proposal. SSE is aware of change proposals being rejected on these grounds despite the consultant in question acting on behalf of several large customers. SSE would support a revision of the codes to allow consultants to raise change proposals to charging methodologies or, more generally, to perform any function that one of their existing customers is able to do. Perhaps this could be based on the consultant providing a declaration from the signatory that the consultant was acting on their behalf.

Simpler charging structure for domestic customers

SSE believes that the domestic supply market is complicated to some extent by the regional variation in transmission and distribution costs – this has inevitably been described as a 'postcode lottery' in energy prices. It would be possible to equalise the network charges for domestic suppliers whilst not affecting the revenue of network companies by creating a clearing house to conduct the collection and apportionment of charges. (An equivalent arrangement effectively already exists for electricity transmission charges, where National Grid performs this function for its own operations and those of SP-T and SHE-T.) This would deliver simplification in the retail market of benefit to consumers whilst avoiding any negative impact on the RAV of network operators. A thorough cost benefit analysis would identify any potential efficiency gains which may help to offset the cost of administering the clearing house function, but it is likely that these costs, though significant, would not be unduly onerous.

**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?**

SSE recognises that there is an opportunity to review the industry codes and re-draft to provide further clarity. Whilst it is inevitable that precise technical requirements will remain, there are areas where incremental improvements can be made. In particular, SSE believes that areas of overlap provide multiple opportunities for consolidation and simplification. SSE is in favour of reasonable and proportionate measures to ensure that processes for providing collateral are efficient; for example, it may be more efficient – and easier for suppliers to manage – if collateral were posted once centrally rather than with each of the electricity DNOs. The other key change that should be made is to standardise the governance arrangements such that all codes are based on the open governance model used in the BSC, DCUSA and CUSC.

The implementation of the ENCs, in particular, will have a significant impact on existing GB codes. The large-scale change required to implement the ENCs into the GB code framework presents a timely opportunity to modify and streamline the GB industry codes arrangements. SSE considers that, as a minimum, the ideal approach would place the existing GB industry codes which focus on upstream operations into the three groupings used for the ENCs, namely: (i) connections; (ii) markets; and (iii) system operation. Thus all of the existing GB upstream electricity codes would, in the future, be consolidated into just three new GB codes, reducing any overlap or repetition. For retail operations, SSE proposes a cross-fuel market code covering customer facing activities (e.g. metering). This code would sit alongside the Data Communications Company (DCC) Service Provider arrangements within the Smart Energy Code (SEC). The two dual-fuel retail codes could be characterised as one covering

interactions between service providers and one covering processes that include direct interactions with customers.

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?**

From a starting point that the individual obligations in the industry codes are all required and that the arrangements reflect a complicated market, then code consolidation alone will not resolve concerns over the resource requirements to understand and comply with the codes. Indeed consolidated codes would cover such a range of topics that the number of committees and workgroups required to discuss proposals is unlikely to change and may even increase.

The industry codes have evolved over time (from when they were first drafted/ approved by industry, Government and/or Ofgem) as and when modifications to particular clauses have been implemented. Modifications have been drafted by multiple parties in a semi-legalistic language which has also led to inconsistent drafting to achieve similar outcomes in different codes.

Additionally, as the individual industry codes have tended to be developed in isolation, there is a degree of scope overlay between codes. These issues add to the difficulty in understand and interpreting the code obligations as a whole. There are opportunities to ensure that the legal text and scope of the codes better express the intent of the provisions.

Due to the complex nature of the energy market, even a set of consolidated and simplified codes will remain a complicated suite of documents. Whilst many code administrators provide guidance material on individual codes, there is limited material that guides parties through the requirements they need to meet across all of the industry codes.

Given that the length of the industry codes has led to concerns that 'complexity' constitutes a barrier to entry and expansion, further steps could be taken to help market participants in all parts of the value chain easily identify the range of obligations which are relevant to their business. This could be achieved through the creation of a virtual single code[5]; a web-service could be established to deliver to each user a digital version of all relevant sections of the various industry codes, based upon the users' input to identify the areas of activity (e.g. supply and gas shipping) that they undertake (or plan to undertake). Maintaining this service could be a joint responsibility of the code panels and code administrators. This approach would also support the effective operation of the overarching strategic codes board described in the Code Administration section above.

[5] Which could be termed a 'combined code' along the lines of the UNC in gas.

**Annex 2 – Energy Code Panels**

| Code | Panel |
|---|---|
| **Electricity** | |
| Master Registration Agreement (MRA)<br><br>*307 pages* | **4 members:** 2 VI (SSE, Eon), 1 network representative, 1 independent (*BSCCo rep*). |
| Balancing and Settlement Code (BSC)<br><br>*888 pages* | **12 members:** 1 VI (SSE), 8 independent experts/others (*Independent Panel Chair, 2 independent members, 1 consumer representative and 4 industry members independent of a BSC Party*), 2 network representatives, 1 generator. |
| Distribution Connection and Use of Agreement (DCUSA)<br><br>*955 pages* | **6 members** (with the option of 7 subject to the Authority): 2 VI (British Gas, Eon), 3 network representative, 1 generator. |
| Connection and Use of System Code (CUSC)<br><br>*1162 pages* | **11 members:** 4 VI (SSE, Eon, SP, EDF), 3 independent experts/others (*Independent Panel Chair, 1 consumer representative and 1 industry member independent of a CUSC Party*), 2 network representatives (only 1 is entitled to vote on a given issue), 2 generators. |
| Distribution Code (DC)<br><br>*196 pages* | **15 members:** 3 VI (Eon, RWE, SP), 4 independent experts/others (*consumer representative, 2 representatives of end-users and 1 industry member independent of a party subject to the Distribution Code*), 7 network representatives, 1 generator. |
| Grid Code (GC)<br><br>*634 pages* | **20 members:** 3 VI (EDF, RWE, SP), 4 independent experts/others (*2 industry members independent of a party subject to the Grid Code, representative of externally interconnected systems and BSCCo rep*), 10 network representatives, 3 generators. |
| **Gas** | |
| Supply Point Administration Agreement (SPAA)<br><br>*506 pages* | **8 members:** 4 VI (British Gas, Eon, SSE, SP), 1 other supplier, 3 network representatives. |
| Uniform Network Code (UNC) *465 pages* | **12 members:** 2 VI (British Gas, Eon), 3 other suppliers, 2 independent experts/others (*Independent Panel Chair (Non-Voting) and consumer representative (entitled to 2 seats but only 1 taken)*), 5 network representatives. |

| | |
|---|---|
| Independent Gas Transporters Uniform Network Code (iGT UNC)<br><br>*241 pages* | **7 members:** 3 VI (SSE, RWE, Eon), 1 independent expert (*Independent Panel Chair*), 3 network representatives. |
| **Both fuels** | |
| Smart Energy Code (SEC)<br><br>*791 pages* | **12 members:** 2 VI (SP, British Gas), 2 other suppliers, 6 independent experts/others (*Independent Panel Chair, 2 consumer representatives, 2 representatives of other users (ESCOs etc.) and 1 representative of DCC*), 2 network representatives. |