

Sent by email

Laura Nell
Code Governance Remedies
OFGEM
9 Millbank
London
SW1P 3GE

3rd February 2017

Dear Laura,

**INDUSTRY CODE GOVERNANCE; INITIAL CONSULTATION ON IMPLEMENTING THE
COMPETITION AND MARKETS AUTHORITY'S RECOMMENDATIONS**

Thank you for the opportunity to respond on the above consultation. We have responded to a number of your specific questions in the attached Annex and outline below the key points we wish to make.

In our previous responses (e.g. to the CMA), we explained there are a number of important considerations to take into account as we move forward with respect to the proposed remedies, noting in particular the 'Recommendations' which propose an Ofgem Strategic Direction, Consultative Board, and in particular the Recommendation that seeks to licence code administration and delivery services.

The recent workshop, hosted by Ofgem on the 12th January 2017, was a really useful exercise. The opportunity to share in open forum thoughts and ideas on how best to move forward was particularly welcome. We look forward to continuing to support your work in this area and will play an active role in helping Ofgem to define the most optimum framework that will deliver the right outcomes against the spirit of the CMA's Recommendations.

In this response, we highlight the following key aspects:

- Securing a licensing framework will, more than likely, be delayed as a consequence of the demanding government legislative timetable (e.g. Brexit). Nonetheless, this time can be put to good effect in the delivery of other measures;
- We support the principle concept of a Strategic Direction and Consultative Board, and believe that subject to correctly framing, these could play a key role addressing the CMA's remedies; and
- The positive role of competition and the benefits this brings has always been central to our company philosophy. The delivery of any measures should build upon and not adversely impact the opportunities to drive cost efficient, high quality, innovative services under codes as we go forward.

Licensing Framework

In our previous responses to the CMA, we explained there are a number of important considerations to take into account towards the licensing of code administration¹. We understand that, by licensing the activities of code administrators and delivery bodies, it is intended to give Ofgem the power to efficiently monitor performance of the relevant code/delivery bodies, give them directions and impose sanctions.

¹ CMA, 17th March 2016. *Energy market investigation*. Paragraph 191 p.41

However, we believe that code contestability must be considered in line with licensing. This is primarily because, code administrators are at different 'starting points' in terms of business models. Without a consistent approach to funding, code administrators will incur different risks which is particularly prevalent with regard to sanctions borne from licensing. The alternative is to devise code specific licensing regimes which introduces its own issues and challenges, not least being how to design them in a manner that does not then act as a market barrier.

Further, the government legislative timetable suggests that, delivery of primary legislation to give effect to licensing of code administration and delivery bodies is very unlikely to happen in the medium term. Consequently, the 2019 delivery date is significantly at risk for a first licence award.

Given the ongoing development of the Strategic Direction and Consultative Board, we believe this delay could be put to good effect as it allows time to fully understand the operational role and nature of the Strategic Direction and Consultative Board as we go forward.

Allowing time for a licensing framework to be properly thought through, not only helps avoid unintended consequences, but critically helps to flush out the benefits the Consultative Board will bring and thereby gain a greater insight and understanding of what aspects surrounding strategic change still need to be addressed.

It is possible that, the combination of the Strategic Direction and Consultative Board is such that it helps sharpen the focus and scope of the licensing regime as and when it is introduced.

Strategic Direction and Consultative Board

Gemserv has been advocating a very similar approach for some considerable time. Our thoughts and ideas were published in our Thought Leadership Paper on Transforming Code Governance Arrangements². For example, we proposed the establishment of a strategic body to oversee strategic direction which is very aligned to the idea of a Consultative Board to serve as a forum for addressing cross-cutting code issues.

With respect to the Strategic Direction, it became very clear to us from the Ofgem workshop recently held, that there are differing interpretations and therefore ideas on the form and nature the Strategic Direction should take. We encourage Ofgem to define what this might look like as soon as possible, because this seems central to what might then be expected of the Consultative Board.

With respect to the Consultative Board, Ofgem have noted that the Board will not have powers as such. Nonetheless, in order to be effective, it will still need to be capable of making requests (e.g. to codes), in order to extract information in a timely and consistent fashion. We agree that powers (as such) may not be required, however the duty to support the Consultative Board and respond accordingly will need to be placed within the codes themselves. We expand in this response on what the responsibilities might entail.

It is possible that, if these two aspects (Strategic Direction and Consultative Board) are framed correctly, and therefore become successful mechanisms to oversee and deliver strategic change, they either reduce the need for licensing or, at the very least, help bring greater clarity to what licensing needs to support going forward.

² <http://www.gemserv.com/insights/thought-leadership-papers/transforming-code-governance-arrangements/>

Code Governance Competition

Gemserv have long been an advocate of a pro-competitive position, including in a recent response to a code change³.

Whilst all industry codes are different in terms of their complexity and what they cover, undoubtedly behaviours change where there is a real risk of competitive pressure placed on those codes and their administrators. Competition in code administration ensures that organisations that look after codes remain focused on the quality of service, it ensures efficient pricing of goods and services and it drives organisations to innovate in order to stay ahead of its competitors. Critically, it ensures they are exposed to any underperformance.

Notwithstanding the obvious challenges of alignment of business models across code administrators, a competitive code landscape will support delivery of the 'code administrator plus' approach that is being articulated by Ofgem. Gemserv has a strong record of doing just that, i.e. increasing value under its code administration services, with recent examples including: the advancement of a single solution for Price Comparison Websites for access to electricity and gas data under Electricity Central Online Enquiry Service (ECOES) and development of a proof of concept for a Market Intelligence Service (MIS) in support of Ofgem's Faster and Reliable Switching Programme.

We accept that code administrators are at different 'starting points' in terms of business models and shifting the emphasis to a more competitive model will be challenging for some. Nonetheless, steps taken now, whether this be with regard to the role of a Consultative Board, the nature and shape of licensing, or the delivery of newly procured services such as the MIS, should be handled in a manner that recognises the need for change towards a fully competitive model. Setting out the direction of travel for a fully competitive code governance framework could become a powerful tool to elicit change and help future proof code governance reform.

We hope you find our comments useful. If you have any comments or questions about this, please let me know as I am very happy to expand and discuss these further with you.

Yours sincerely,

Anne Jackson
Principal Consultant, Transformation

³ <https://www.elexon.co.uk/wp-content/uploads/2015/12/P330-Assessment-Procedure-Consultation-Responses-v2.01.pdf>

ANNEX 1

CHAPTER: Two: Scope of the new arrangements

Question 1: Do you agree that the codes and functions we have identified (i.e. the codes within the scope of the CACoP and their associated central system delivery functions) should be within scope of the new regime?

Question 2: Are there any other codes or systems that should be within scope and if so please give your reasons?

Question 3: Are there any other factors you think we should consider when making this decision?

Gemserv believe that the codes (currently in the market) that will come under a new regime have been successfully identified. The assessment criteria of the codes put forward are clear:

- To whom the code is accountable (generally multiples of licensed parties e. g. suppliers);
- the ability of the code to materially impact strategic change;
- the volume, spectrum and scale of changes possible and
- the scope of the code particularly in relation to consumer impacts.

We support these criteria, although in order to apply transparently and consistently, it will be important to have a clear definition of strategic change. Furthermore, within the context of a new regime, clearly identifying the role of CACOP will be essential (especially if it is required for all codes to adhere to CACoP).

As we expect the timescales for licensing to be further extended and because major reform will pose a significant risk to the projects that are currently in flight, we think a more targeted approach, building on Ofgem's existing powers and the Codes' governance, may suit the sector better in the short to medium term.

To illustrate we have an example (implementation of the Green Deal Central Charge Database (GDCC)); the Secretary of State (SoS) directed suppliers to deliver the GDCC under the MRA by a specified date. These were transposed in terms of deliverables within the Code and required additional project management support from the code administrators. The approach was structured under a formal programme management framework using recognised programme standards and engagement methods, throughout the programme life cycle (design, build, testing and implementation) in keeping with agreed budgetary controls and milestones. This provided the SoS (with respect to the GDCC under the MRA), clearly defined deliverables and delivery confidence. The programme was successful and handled without recourse to licensing of any code administration services.

CHAPTER: Three: Licensing and competition

Question 1: What are your views on our proposed approach of including the code manager and delivery body function in a single licence?

Question 2: What are your views on strengthening the licence of NGET to include new code management requirements rather than holding a tender to identify an appropriate code manager?

Question 3: What are your views on the merits and drawbacks of the four identified models for competitively licensing code management where applicable?

Question 4: What are your views regarding which model(s) may be appropriate for different codes, or types of codes?

Gemserv believe that the proposed new regime needs to be identified and then the needs and the relative positions of each code should be reviewed against it.

On the assumption that the model to be implemented has been reviewed and the incentives operate appropriately, then the current code models can be compared to see if they would operate efficiently and appropriately under the new model and within the energy code governance space and the appropriate measures taken at that time to alleviate any difficulties.

Competition

Gemserv strongly support the use of a competitive application process and note that it would be used in all the models. We believe that this is the best way to achieve the correct balance for service and cost. At this stage it is not possible to comment whether simply strengthening NGET's licence is the right way forward, until there is greater clarity. As a matter of principle we believe that competitive pressures will drive continued efficiency and an increase in innovation and therefore, we do not believe there should be any exceptions to this.

When applying a competitive application process it is important that all parties' positions are equitable. Consideration needs to be given to the financing of organisations administering current codes, as they are not all the same and some administrator organisations do not have access to non-code revenue. It is important that the code parties from one code are unable to subsidise the competitive applications to or the management of another code.

All the models should allow the code parties and Ofgem to work together collaboratively in the procurement process to select the appropriate service provider.

The amount of time and effort required in conducting these exercises should not be under estimated and individual reviewers must be suitably qualified to make judgements on behalf of Codes, Ofgem and all the energy parties.

It has not been indicated how the winning 'applicant' would balance the needs of Ofgem with the needs of parties in their role, so determining that balance and how it will be achieved will also need to be identified when selecting the appropriate service provider.

Licensing

Gemserv believes that if a licence is to be used, then the consequences of breach should have some proportionality to the damage or difficulties that can be caused by the role. It is difficult to judge the use of licensing within the model as the consultation has not specified:

- The spectrum of responsibilities that will fall under the licence and the role
- How the role will be incentivised.
- How Ofgem will respond to the challenge of applying a licence where the constructs of the delivery bodies, the codes and their code administrators are all different.

Any party that has strong licence incentives connected to the delivery model, the content of the changes and the implementation dates, that is also responsible for the change process, could deliver a bias into the process, i.e. a perverse incentive, which could be damaging to consumers and the energy sector in unexpected ways. We would support testing the incentives prior to application.

Licensing activity requires the licensed body to put in place additional compliance requirements. This would add an additional layer of cost for the code management function and therefore on code parties that will ultimately find its way to the energy customer. It is unclear that there are benefits that would outweigh these costs.

We also have a more general concern that licensing by code could have the unintended consequence of strengthening the code's focus on licence compliance, which would be detrimental to cross-code changes and co-ordination and in particular where change spreads across the gas and electricity sectors.

Code Managers

The definition of Code Manager is that it is an expanded role of Code Administration. What defines the 'expansion' should be clarified, but it seems to involve 'delivery'. The consultation also refers to the 'delivery body function'. These roles could be better defined before determining whether the activities should be placed under a single licence.

Code administrators have clear vires to deliver under their contracts or via the relevant code. Their roles can and have been expanded as a Code requires. This has seen Gemserv becoming involved in the delivery of ECOES for example. Code administrators can and have stepped into an expansion of their role at the request of their client and code agreements could be amended to ensure this request is made as and when required. Consequently, we would argue that code managers already exist for some codes and that their value in the code governance arena is being understated.

CHAPTER: Four: Strategic direction

Question 1: Do you agree with the purpose of the strategic direction?

Question 2: Do you have any views on how the strategic direction should be developed and implemented?

Question 3: How much detail do you consider should be included in the strategic direction?

Purpose

Gemserve believes in the strategic direction's potential benefits and supports Ofgem laying out its expectations of the code parties.

The direction will also place consumers at the heart of change.

Content

How the strategic direction is developed and implemented is critical and we suggest that it should be framed to provide markets with enough information to provide absolute clarity on the strategic steer.

The Strategic direction needs to:

- provide absolute clarity on policy and measurable outcomes,
- provide goals (short, medium and long term)
- indicate priorities,
- include impact and benefit analyses,
- give an indication of the 'scale' of change,
- provide the sector context,
- provide timescale aspirations and
- provide any assumptions.

As it will be interpreted by code parties, codes and code managers, all must interpret and reach the same conclusions.

We would like further clarity on how the strategic definition might be communicated by Ofgem. For example, would it be as an Ofgem 'command' indicating specific tasks to be achieved or as a strategic objective, from which the code parties determine the building blocks required for delivery? The difference is illustrated by this example: deliver faster and more reliable switching or improve the switching process for consumers. There is also a question about to whom the direction will be addressed.

Innovation may be at risk with a strategic direction, particularly if the innovation does not align with it neatly. The direction might also limit and focus attention on the strategic intent only.

Implementation

We believe that the consultative board (CB) will play a fundamental role in adding flesh to the draft strategic direction. It can contribute by:

- Advising on the realism of any delivery expectations or aspirations;
- providing any sector context that may need to be highlighted;
- adding definition to Ofgem expressed requirements;

- undertaking consultations, workshops and other stakeholder engagement, and
- determining the magnitude of change required for successful delivery.

As much of Industry change takes some years to develop, the strategic direction may need to indicate short, medium and longer term aspirations. For example:

- Short means change is under way, i.e. under the code's change control mechanism, beyond design and in build/preparation and moving towards implementation;
- Medium means change has been developed and planned, could be about to enter design stages; whereas
- Long means change where planning needs to take place to ensure there is adequate budgets, resources etc. to deal with what is coming.

For this reason, we would support the early implementation of both the strategic direction and the CB to begin this process and gain benefits for the change already in flight. This includes faster and more reliable switching, smart meter roll-out, UKLINK replacement (NEXUS), half hourly settlements, implementation of the EU Codes and code governance reform, which should be included in the strategic direction as short and medium term goals.

However, it should also show what is on the horizon in terms of policy. These items will gradually have greater detail added with each published iteration of the direction. Change on the horizon now will be the subject of the first binding direction and advance preparations will be needed from parties for delivery.

CHAPTER: Five: Consultative board

Question 1: What do you see as the core role and functions of the consultative board?

Role

We support the role outlined for the 'consultative board' (CB) and defined below:

- i. Inform the content of the strategic direction and assist Ofgem with the coordination of cross-code changes, including the strategic direction
- ii. Develop and maintain a joint industry cross code change plan to facilitate delivery of the strategic direction and ensure consistency across codes
- iii. Perform an assurance role for delivery of the strategic direction/ joint industry plan
- iv. Provide a mechanism to improve Ofgem's understanding of the substantive scope of the code regime
- v. Perform a risk management/ risk mitigation role
- vi. Make non-binding recommendations to Ofgem on strategic code development, which we can decide whether to accept
- vii. Facilitate engagement between the industry, Ofgem, code panels, code parties, code managers and delivery bodies
- viii. Share best practice, learning and experience

These are very closely aligned to the objectives of the 'Strategic Body' outlined in our Thought Leadership Paper 'Transforming Code Governance Arrangements – A way forward'(January 2016)⁴ .

For maximum effectiveness, how these roles are performed will be fundamental to the success of the body and the delivery of the strategic direction.

The CB will be very influential and it is important that it is able to demonstrate that it forms a credible voice for all stakeholders and Ofgem and all will need to be assured of that.

Being more specific, the CB must:

- Ensure that the advice it provides has been undertaken with due diligence and regard for the market wide change context underway;
- Provide experts in their fields;
- Be strategically knowledgeable to understand how to provide that advice and the consequences of it;
- Be independent and impartial with respect to the advice they provide;
- Be accountable for the advice they provide;
- Be able to support their advice with analyses and evidence;
- Be able to determine priorities considering all possible factors; and

⁴ 'Transforming Code Governance Arrangements – A way forward' (January 2016)

- Be sensitive to confidentiality and data protection considerations.

Governance

The diligence of the Consultative Board in fulfilling its role is very important. To a degree, stakeholders may have to be required to respond to RFIs or consultations issued by the board. Ofgem have these powers but the Board would not. Also stakeholders need to feel that there is no risk to sharing all necessary detail, commercial or otherwise. So the Board must be independent of stakeholders and transparent if it is to obtain a true picture of the situation. The consultation indicates that the Board will have no powers, which means that stakeholders may not always choose to participate. This will impact the quality of any analysis and therefore the quality of the advice provided to Ofgem.

For the CB to fulfil its potential within the governance model, the incentives of all parties will need to be balanced. The Board must find solutions that work and in appropriate timescales. It must have no desires other than to see Ofgem's strategic change (and other change) implemented successfully in a timely manner for the good of consumers and the energy sector's reputation.

We do have a concern that the Board is likely to identify when parties need to take action, to mitigate both low level and significant risks. However, it is envisaged that advice on the matter would be provided to Ofgem. It is not clear what would happen to that advice, what level of impact might induce Ofgem to take action and how Ofgem might take action. This information is needed to 'test' the model.

We believe that if the market is going to fund a new body, then it should get maximum value from it. The Board will gain a valuable insight to change across the energy sector and to a large degree this should be shared with participants to enable the codes and parties to manage the risks themselves. This also fits with Ofgem's aspiration to avoid becoming deeply involved in the change and implementation process and assists in retaining Ofgem's role and status as the ultimate decision maker on material changes.

We would expect a route for CB observations and advice to be passed to parties and code managers, who could take appropriate action without involving Ofgem.

A couple of measures would assist in providing assurance to parties around these points.

1. The CB developing a 'governance framework (light)' for itself and
2. The existing codes placing a duty within them to support, provide information to and possibly address advice from the CB.

This would complete a governance and assurance circle to give all stakeholders confidence in the CB role and its outputs.

CHAPTER: Six: Moving to new arrangements

Question 1: What are the main impacts of the proposed new arrangements on existing projects?

Question 2: Would Ofgem's enhanced powers over strategically important modification proposals mean that our Significant Code Review (SCR) powers will be obsolete, and will the new powers form an effective substitute? Please explain your reasoning.

Question 3: What are your views on staggering the implementation of competitive applications for licences?

Implementation

Due to the legislative challenges of BREXIT, it seems that the licensing regime is further away than Ofgem first envisaged. This can be seen as an opportunity and assist developing confidence in the ultimate governance model that is being developed.

Additionally, there are a number of risks with changing the code governance regime whilst it is delivering other major programmes of change. We are specifically thinking of the faster, more reliable switching programme which crosses codes in both the gas and electricity markets, but there is other significant strategic change in flight.

Much of this current strategic change would have benefitted from a new cross-code approach embracing priority setting and planning. Unfortunately, any new regime is likely to be fully implemented post the delivery, or well through the delivery of these projects.

That said, we believe that the early implementation of both the strategic direction and the 'consultative board' (CB) could have benefits by:

- Assisting with existing strategic change that is currently in flight;
- Bedding down the roles and responsibilities;
- Testing incentives and drivers within the model;
- Refining and building stakeholder confidence;
- Testing existing code models within the model; and
- Testing the continuing need for Ofgem's SCR powers.

In order for the energy sector to move forward in the right way, it is important that the appropriate facts with supporting evidence are provided so that the best decisions can be made. This will be dependent on the whether the CB's role is successful and reduces referrals and appeals to Ofgem.

Impacts

The main impact of the delivery of a new code governance regime in parallel with existing projects is that the work will detract from the projects, putting their success and delivery timescales at risk. Codes are largely run by parties in a voluntary capacity and moving to a new regime will inevitably require more time and effort from those same parties for another new project. Current code administrators could take some of the workload burden, where directed by their code, both for the code governance revisions and the ongoing projects. However, fundamentally changing the code governance regime whilst it is focussing on the delivery of other projects will place an additional significant risk on all the projects.