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Consultation on Reforming the Energy Industry Codes

Thank you for the opportunity to respond to your consultation in relation to the above[1]. As a Gas Distribution Network (GDN) our responses are focused around our experience with the relevant gas industry codes – specifically Uniform Network Code (UNC), the Supply Point Administration Agreement (SPAA), the Smart Energy Code (SEC) and the Retail Energy Code (REC), although we have provided wider observations where we are able.

For the purposes of ease of comparison with other respondents, we have structured our response around the questions as posed in your consultation document.

Chapter 1 - Background

1. Do you agree with our four desired outcomes for the code governance landscape by the mid-2020s?

We agree with the desired outcomes described in Chapter 1.3 (page 13).

2. Do you agree with the problems we've identified, and that they present a persuasive case for reform of the current framework for energy codes?

We agree to a certain degree with the issues identified in Chapter 1.3, Table 1 (page 13), although would make the following observations:

Challenge Identified: Fragmentation and lack of coordination

Slow to implement change

Development timescales of UNC modifications are reported and reviewed on a monthly basis by the UNC Panel and new modification proposals are expected to propose an efficient but realistic reporting timeline. Any extension requests are considered on an individual basis, and where a request is made on a repeated basis, or as a consequence of a perceived lack of progress, this feedback is provided back to

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/828302/reforming-energy-industry-codes-consultation.pdf

the workgroup and proposer with the clear expectation that the proposal be developed or de-prioritised.

We therefore consider that insofar as the current governance allows, development timescales are tightly managed, however we acknowledge that this could be improved through greater coordination and a clear and shared strategic direction.

Fragmented with a large number of code panels and bodies

The gas industry has a relatively greater degree of centralization than seen in electricity, with a single main gas-only code (Uniform Network Code) which is itself a centralized code covering all common elements of gas distribution network operations. This model has been replicated by the Independent Gas Transporters (IGTs) with the IGT-UNC. Other gas-relevant codes such as the SPAA, SEC and REC also cover electricity and multiple user types and therefore again demonstrate a high degree of centralization.

We consider that further centralization could be achieved through the consolidation of IGT-UNC into UNC, with the panels and workgroups also being combined. However, elsewhere we consider that the gas industry is highly consolidated with an appropriate number of code panels and bodies.

Lacking co-ordination between different code bodies

Coordination across codes has been an area of improvement, especially following the CMA Energy Market Investigation Report[2] in June 2016 and the subsequent Ofgem Industry Code Governance consultation[3]. Through the Code Administrators Code of Practice (CACoP), a common modification proposal template[4] has been implemented which includes specific consideration of cross code impacts. This has led to greater coordination when a UNC change requires an equivalent IGT-UNC or SPAA change, enabling concurrent development and implementation.

We therefore consider that there is a high degree of coordination between code bodies within the gas industry.

Challenge Identified: Lack of Incentive for Change

Reactive to existing problems, rather than forward-looking

We agree that the existing arrangements tend to focus on the near-term future.

There are examples of where gas industry parties have worked collaboratively to deliver a series of modification proposals enabling large-scale change – for example the Project Nexus modifications (UNC 0432[5] and 0440[6]). However, we also agree that there are examples where the existing arrangements have struggled to produce conclusive agreement - for example the recent series of transmission charging modifications (UNC 0621[7] and 0678[8], plus alternates). Such modifications are likely to have progressed more smoothly had they been managed as part of a Significant Code Review (SCR) and as such are good examples of where a more formal strategic direction may be of benefit.

[2] https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf
[3] https://www.ofgem.gov.uk/system/files/docs/2016/11/industry_code_governance_-_initial_consultation_on_implementing_the_competition_and_markets_authoritys_recommendations.pdf
[4] Modification Template: https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/page/2018-11/Stage%2001%20UNC%20Standard%20Modification%20Template%20v3.0.doc
[5] http://www.gasgovernance.co.uk/0432
[6] http://www.gasgovernance.co.uk/0440
[7] http://www.gasgovernance.co.uk/0621
[8] http://www.gasgovernance.co.uk/0678

Challenge Identified: Complexity

Overly complex

Page length and printed weight are not necessarily the best measure of whether code documentation is fit for purpose. Rather, content and accessibility should be considered.

For example - UNC is frequently cited as being a contractual, rather than operational, document. Therefore, whilst it defines the arrangements, any more detailed specifications are held in an appropriate supporting document. This keeps UNC at the appropriate level and ensures that content is judged based on purpose rather than length.

As a further example - SPAA uses a schedule approach which provides guidance to parties on whether it is mandatory, optional or N/A. This ensures that the document is accessible to less familiar parties as it helps direct attention to the appropriate sections. The REC, which is designed to represent best practice, has subsequently adopted a schedule structure.

We consider that consolidation of codes where it is appropriate, such as IGT-UNC into UNC, and SPAA into REC, is beneficial to the industry in terms of efficiency and accessibility. However, measuring codes based on page length would prohibit such consolidations and therefore prevent the benefits from being realized.

Therefore, whilst we agree that excessive complexity in codes should be avoided, we consider that this should be judged based on alternative measures.

Resource-intensive to engage in the process

Since 2013, approximately 300 modifications to the UNC have been proposed, raised by approximately 30 different organisations[9]. Whilst the raising of changes is one indicator of engagement with a given code, this would also impacted by a variety of factors, such as the resourcing and appetite levels of code parties to raise changes, and the relative maturity of the code.

The Joint Office of Gas Transporters, who administer the UNC, have calculated the average development lifespan of a UNC modification proposal to be 156 business days. In the 12 months to 1st September 2019, they held 287[10] workgroup meetings and a total of 445 workgroup and committee[11] meetings.

Steps are taken to enable engagement in the UNC modification process as much as possible. For example, all meetings include teleconference and screen-share facilities, and the modification process includes a consultation cycle, which offers parties unable to attend workgroups the opportunity to formally provide their feedback.

However, we acknowledge that smaller industry parties may still struggle to resource this level of engagement.

3. Do you have additional evidence on the performance of the current framework?

Examples provided within our response to question 2.

4. Do you agree with our proposed scope of reform?

We agree with the reforms described in Chapter 1.5, Table 2 (page 15). We agree with the scope articulated in Chapter 1.6 (page 17).

[9] Taken from the Joint Office of Gas Transporters Modifications Register https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/book/2019-09/Modification%20Register.xlsx

[10] It should be noted that Transmission Charging Modification proposal 0678 accounted for 21 of these workgroups

[11] IT should be noted that certain committees involve the same participants and as such are conducted on the same day, such as UNC Modification Panel and Uniform Network Code Committee.

5. Are there any codes or systems that we should only apply a limited set of reforms to?

None identified.

2. Vision and Options

6. Do you agree that the four areas for reform are required?

We agree with the four areas for reform identified in Chapter 2.2 (page 19).

7. Do you agree with the two broad models outlined?

We agree.

8. Which model do you believe will best deliver on our desired outcomes?

We support the introduction of a Strategic Body as we consider this will provide direction to the industry and enable collaborative delivery in line with Government policy expectations.

We consider that the Strategic Body and Code Manager functions will require specific, and discreet, skills. As Model 1 holds these functions in separate bodies, and Model 2 appears to describe separate teams within the Integrated Rule-Making Body (IRMB), we consider that either model could adequately deliver these functions.

However, we prefer Model 1 over Model 2 as we consider that the complete separation of the Strategic Body and Code Manager has the added benefit of a hierarchical arrangement, whereby the Strategic Body is able to oversee the Code Manager and, from an independent position, monitor performance.

9. Do you agree with the changes to the role of code signatories we are proposing?

We agree that engagement with industry participants is important (page 21) and consider it to be important that participants continue to be involved in the development of code changes.

However, we would welcome further clarity on the proposed enhanced independence of decision making. For example, Table 4 (page 23) appears to indicate that code signatories would no longer be responsible for approving modification proposals for implementation, and as such that self-governance procedures would be removed. This would be in contrast to the recent expectation expressed by Ofgem that the industry become more autonomous – demonstrated through implementation of Code Governance Review Phase 3, under which UNC modifications were changed to have a default status of self-governance unless materiality, and therefore the requirement for Authority Decision, could be demonstrated[12].

3. Providing Strategic Direction

10. Do you agree there is a missing strategic function for codes development in the energy sector and that introducing a strategic function with the responsibilities outlined in chapter 3 is the best way to address the lack of strategic direction?

We support the introduction of a strategic function and support the responsibilities outlined in Chapter 3.3 (page 25). We also agree with the description (page 25) that the Strategic Body should be "held accountable", "impartial" and should have "the appropriate skills and capabilities".

We do not agree that the Electricity System Operator (ESO) should undertake this role, as we consider that there may be insufficient impartiality and industry knowledge to adequately manage topic areas beyond electricity transmission.

[12] Self-governance guidance for UNC Modifications: https://gasgov-mst-files.s3.eu-west-1.amazonaws.com/s3fs-public/ggf/UNC%20%E2%80%93%20Self%20Governance%20Guidance%20v1.0_1.pdf

We consider that Ofgem could undertake this role. As the Strategic Body will need to work in close alignment with Ofgem, having this function delivered by Ofgem could remove an otherwise additional layer of governance and potential complexity. However, we agree that this would require additional capabilities and share the concerns raised in Chapter 4.2 (page 32) that the management of detailed technical processes would be a significant extension to Ofgem's role. Furthermore, an Ofgem-based Strategic Body may only be suitable in the event that Model 1 is selected, where the complete separation of the Strategic Body and Code Manager would create clearer boundaries.

Our preference would be that an independent body, comprised of industry and customer representatives, undertakes the Strategic Body role. As above, they would be required to work closely with Ofgem and as such we also consider that the body should include Ofgem representatives. We consider that this approach would be suitable regardless of Model 1 or 2 being selected, and the body would be most able to flex by gaining or replacing representatives and expertise based on the prevailing strategy and policy under delivery.

11. Do you agree with the objectives and responsibilities envisaged for the strategic function, and are there any additional objectives or responsibilities the strategic function should have?

We agree.

12. How may this new function potentially impact the roles and responsibilities of other parts of the framework? Do you foresee any unintended consequences?

We consider that greater detail is required before a full impact assessment can be made – much of this may be covered by the questions highlighted in Table 5 for further development (page 28).

13. What are your views on how the strategic direction should be developed and implemented (including the option of establishing a strategy board to aid engagement)?

We support the use of a strategy board and engagement with stakeholders. It may also be possible to take learnings from other sectors or markets which may use a similar model.

14. Do you think that the scope of the strategic function should be limited to taking account of the Government's vision for the energy sector and translating it into a plan for the industry codes framework, or are there other areas it should address (for example, impact on vulnerable consumers)?

We agree that the primary objective of the Strategic Body should be translating Government vision into a plan for the industry codes framework. We would expect that other areas (such as impact on vulnerable customers) would naturally be considered as part of the policy and plan developments, and as such benefits to such areas would already be embedded in the target arrangements.

4. Empowered and Accountable Code Management and Independent Decision Making

15. Do you agree that in addition to the current responsibilities that code administrators have, that the code manager function should also have the following responsibilities?

a. identifying, proposing and developing changes (analysis, legal drafting etc.), including understanding the impacts;

b. making decisions on some changes, or making recommendations to the strategic body; and

c. prioritising which changes are progressed.

We agree.

16. What is the best way to ensure coherent end-to-end changes to the codes and related systems? For example, is it through having end-to-end code and system managers?

We consider that clear governance procedures and clear lines of responsibility are the best method of ensuring coherent codes and system changes.

17. Should the approach differ on a case-by case basis (i.e. depending on the code or system in question)?

Whilst there should be as many common practices as possible, we agree that the approach may need to differ based on the specific requirements of a certain code and the specific ownership arrangements of the associated system.

18. Do you agree that the code manager function should be accountable to the strategic body and that this should be via a licence or contract?

We agree that the Code Manager should be accountable to the Strategic Body, via a licence.

19. Are there more effective ways that the code manager function's accountability to the strategic body could be enshrined other than in a licence or contract?

The licence should be supported by a clear set of objectives, key performance indicators and deliverables.

20. Do you agree that we should not consider further a model whereby the code manager function is accountable to industry?

Whilst industry should be able to provide feedback to the Strategic Body in relation to the Code Manager's performance, having the Code Manager being accountable to industry is not in keeping with the trajectory of a more prescriptive policy delivery model.

21. Do you have views on whether the code manager function should be appointed following a competitive tender process or other competition?

We agree in principle that competition, through a tender or otherwise, is beneficial. However, it is important that the highly specialised activities required do not inadvertently limit the number of responses.

22. Do you think the code manager function should be established by the strategic body creating a body or bodies? If the code managers were established in this way, would we need to consider any alternative approaches to funding or accountability?

We agree. Once the codes structure is agreed, the appropriate Code Managers should be established, in line with the accountabilities and responsibilities as set by the Strategic Body.

Greater clarity on the enduring codes structure would be required in advance of the funding mechanism being established.

23. In terms of establishing/choosing the code manager function, do you agree that we should not consider further:

a. requiring an existing licensee to become the code manager; and/or

b. requiring a licensee (or group of licensees) to create the code manager?

We agree.

24. What would be the most effective way to ensure the code manager function offers value for money (for example, through price controls or budget scrutiny)? More broadly, what is the right incentive framework to place on the code manager function?

Steps to ensure that the funding arrangements offer value for money can be established once greater clarity is available in terms of the target operating model.

25. Are there any factors that:

a. would stop parties (including code administrators) from becoming a code manager?

b. should prevent parties from becoming a code manager (e.g. do you agree that licensees should not be able to exercise control of the code managers)?

The skills and capabilities required of a Code Manager are likely to be in excess of those held by a Code Administrator, which may be limiting to organisations currently performing the latter service. Should there be a service gap, this will be more clearly identifiable once the specification for Code Management activities is available.

Licensee influence over Code Managers will need to be judged once the new arrangements are more clearly defined and may depend on amendments to associated licence conditions. For example, the Gas Transporters currently have a licence obligation[13] to administer the UNC. As such, the Joint Office of Gas Transporters is owned and funded by the Gas Transporters, although it operates independently in order to maintain impartiality amongst UNC parties. Such an arrangement, and the associated licence obligations, would need to be considered if the ambition is to move to a model where Code Managers are entirely separate from licencees.

26. How should the code manager function be funded (for example through licence fees or by parties to the code(s)?

Funding arrangements can be established once greater clarity is available in terms of the target operating model.

<u>Code Simplification and Consolidation</u>

27. Are there any quick wins that could be realised in terms of code consolidation and simplification?

We consider that the REC has already delivered several quick wins, for example by consolidating SPAA and the Master Registration Agreement (MRA).

As discussed in our response to Question 2, the gas industry already demonstrates a high degree of centralisation. There is the opportunity to further this by consolidating IGT-UNC into UNC, which would reduce the number of workgroups and panel meetings, as well as reduce industry expenditure in relation to legal text.

28. How many codes would best deliver on the outcomes we are seeking under these reforms?

We do not think that Option A, a unified single code (USC) is appropriate. If this were to cover gas and electricity, transmission, distribution and retail, there is the risk that the governance and funding arrangements would become onerous and less accessible for new entrants. This would also require parties to become engaged in a code covering activities for which they have little involvement – for example a challenger gas supplier would be party to a code also covering electricity transmission.

Option B is beneficial as it offers consolidation where commonality of arrangements exists. The REC is a good example, whereby the centralised switching arrangements will become common across electricity and gas, and it is therefore logical that governance is delivered by a single code. The wholesale market may offer similar consolidation benefits insofar as the arrangements are relatively common across both

[13] Standard Special Condition A12 – Joint Governance Arrangements

fuels. However, network activities are likely to differ significantly between gas and electricity and as such little benefit would be realised by implementing a single code covering both fuels.

Option C is therefore our preference. We consider it appropriate to consolidate common activity types (as per Option B) but agree that the benefits of a duel-fuel code beyond the retail market are likely to be limited. We agree that Option C has the benefit of maintaining technical and governance expertise with the relevant code.

29. Which option (one code manager versus multiple) would best deliver on the outcomes we are seeking under these reforms?

We agree that Option A could offer a single source of contact and information, which may be more accessible for less engaged parties or new market entrants. However, such a model would require a wide breadth of knowledge, which would be difficult to build and may create operational inefficiency in the short term. Any efficiency in centralised functions such as HR may be mitigated by the size of organisation which would be required to deliver a meaningful service across full industry governance.

Our preference is Option B. Having a dedicated Code Manager per code enables the retention and application of esoteric knowledge and experience, and we agree that this approach may also facilitate benchmarking and greater future competition. It would still be possible to implement the commonality of contact and information as described under Option A, through website signposting and adopting common practices wherever possible, to build upon the work already implemented through CACoP.

30. Which of our consolidation options would best deliver the outcomes we are seeking to achieve? Please provide evidence for your examples.

As per our response to question 28, we consider that Option C will best deliver the sought outcomes (as described on page 7).

For example – codes being aligned with market activity will make it easier for a market participant to identify the rules which apply to them (outcome 1). Codes being focussed by topic should make it easier to implement Government policy (outcome 2) in a quicker and more agile way (outcome 3), as impacts and required changes could be easily identified by knowledgeable and varied participants (outcome 4).

31. Do you agree that the codes should be digitalised?

We agree.

UNC in particular is already available online in PDF form, separated by section and searchable by key terms. Associated documents and guidance documents are also stored online. The SEC follows a similar structure, and both codes are supported by websites which are easy to use. This works well, however further digitization, such as the golden thread, would be welcomed. It is our understanding that the REC will be digitized in this manner.

6. Monitoring and Compliance

32. What role should industry have in monitoring code compliance or making decisions on measures needed to address any identified non-compliance?

Under the existing arrangements, the gas industry has been encouraged to behave reasonably autonomously, and this extends to monitoring compliance. In UNC, this is delivered through the Performance Assurance Committee (PAC)[14]. Furthermore, cross-sector consolidation is again demonstrated through the duel-fuel Erroneous Transfer Performance Assurance Board[15] (ETPAB), the first of its kind, implemented through SPAA and the MRA.

[14] http://www.gasgovernance.co.uk/index.php/PAC
[15] https://www.electralink.co.uk/2019/06/spaa-launch-et-pab/

The PAC and ETPAB demonstrate that the industry is capable of self-monitoring compliance and recommending steps to address non-compliance. Such an approach could continue in the future and would have the benefit of utilising the high level of knowledge and expertise within the industry.

Equally, if the intention is a more prescriptive approach with less industry autonomy, a compliance monitoring role could be undertaken by the Code Manager and reported to the Strategic Body.

33. Which of the two models we propose would better facilitate effective monitoring and compliance arrangements?

Either model could facilitate monitoring and compliance.

34. With Model 2 - integrated rule-making body - should the IRMB have responsibility for imposing measures (where a party is non-compliant with the code) or should this be for another organisation? Please explain. ***Please note this question only applies in respect of Model 2 (integrated rule-making body).***

We consider that Ofgem should be responsible for imposing measures, albeit the IRMB (or other compliance body under Model 1) could make recommendations based on its findings.

Should you require any further information with regards to our response then please do not hesitate to contact me at Hilary.Chapman@SGN.co.uk

Yours sincerely,

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