

Date

16 September 2019

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Industry Code and Licensing Team

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**Electricity Systems Team**

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Dear Colleague,

Consultation - Reforming the Energy Industry Codes

Thank you for the opportunity to respond to the joint Ofgem and Business, Energy and Industrial Strategy (BEIS) consultation: 'Reforming the Energy Industry Codes'. This response is made on behalf of Cadent and can be published by Ofgem and BEIS.

Cadent is supportive of the proposal for reform which is being proposed to address concerns of a fragmented framework and better facilitate strategic changes in the sector, whilst unlocking innovation and significant benefits to consumers.

Ofgem and BEIS will be aware we have been a strong advocate of managing change within a strategic context, particularly given the pace, complexity and diversity of change that the industry has and is currently experiencing. This is likely to continue and in the absence of a coherent strategy, accompanied by unambiguous priorities, collectively there is a risk that the industry may not be able to deliver the improved outcomes and services that customers need.

In relation to the proposed new institutional framework, we are supportive of the model which sees a separation between the Code Manager and Strategic Body functions. We welcome code simplification and digitalisation, and consolidation by fuel; ensuring gas and electricity codes remain separate. For example, the Uniform Network Code (UNC) and the Independent Gas Transporters' Uniform Network Code (IGT UNC) could possibly be consolidated whilst the electricity codes are similarly treated but remain separate from gas codes. Taking this

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approach would mean that both sectors could focus on their priorities, with the strategic body providing the overarching coordination across electricity and gas. We do not support a unified single code (USC).

We support the proposals for code managers. We believe that there should be a different code manager for each gas and electricity sector. This would enable benchmarking code manager performance. Any concern around inconsistencies in the strategic direction of codes would be mitigated by the overarching strategic body across the two code managers. However, the role of a code manager is significantly wider than the existing arrangements in gas where the Joint Office of Gas Transporters provides an efficient, low cost code administration service to the gas industry. Whilst we support the proposal of a code manager, this issue would need to be examined carefully to identify a solution that builds upon the existing strengths and meets the needs of gas transporters, shippers and their customers.

We do not support the appointment of the Electricity System Operator (ESO) as the strategic body. ESO is fundamentally an electricity function and has no experience in the gas industry. We would instead support establishment of a new entity which has a balanced approach and the skill set to assess change on a whole systems basis between both electricity and gas.

There will be consequential impacts on the licence obligations of Gas Transporters and potentially other licensees. Ofgem will need to provide clarity on the licence obligations of all parties as misalignment between obligations and control will lead to inefficient processes and costs to consumers.

The timelines provided indicate that work is expected to be undertaken by 2025, which falls within the RIIO 2 Gas Price Control period. If Gas Transporters are required to resource and fund elements of these reforms, consideration should be given within the RIIO2 Price Control Framework.

Our responses to the individual questions within the consultation are set out below.

Please contact me should you wish to discuss any aspect of this consultation response.

Yours sincerely,

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Cadent

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Continuation sheet

Questions:

Background and scope of this review

1. Do you agree with our four desired outcomes for the code governance landscape by the mid-2020s? Yes/No/Don't know. Please explain. If you disagree, please explain what you consider the outcomes should be.

We are in agreement for an energy code framework which is agile, forward-looking and facilitates industry parties to innovate for the benefit of customers and to address the climate change challenge.

2. Do you agree with the problems we have identified (in chapter 1 – Background – and in later chapters), and that they present a persuasive case for reform of the current framework for energy codes? Yes/No/Don't know. Please explain.

We are broadly in agreement with the challenges outlined, however we don't believe there to be fundamental problems within the gas codes which are largely centred on the Uniform and IGT Uniform Network Codes. We do recognise the need for and welcome strategic direction across the codes and greater coordination across gas codes as well achieving simplification and digitisation.

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

We have no quantified evidence to provide at this time although performance could be improved in gas through prioritisation of modifications and placing onus on modification proposers to ensure modifications are thoroughly developed and have a broad level of stakeholder support before legal text is required.

4. Do you agree with our proposed scope reform? Yes/No/Don't know. Please explain. If not, which additional codes or systems do you think should be included/excluded?

We are broadly in agreement and support the need for co-ordination between the different codes. We don't see fundamental problems within the gas industry but would welcome reforms, such as consolidation of gas codes and the introduction of a Code Manager. We believe the proposals to merge codes are sensible, but the split between gas and electricity should remain so that gas does not become subsumed or treated as a secondary consideration to electricity-based solutions. It should be remembered that gas provides considerably more energy to UK customers and indeed is essential for peak heat requirements in winter. To enable a balanced whole system approach both gas and electricity solutions must be given equal consideration and therefore a codes framework that maintains the integrity of the two energy vectors will ensure the most efficient and co-ordinated pathways are undertaken.

5. Are there any codes or systems that we should only apply a limited set of reforms to? Yes/No/Don't know. Please explain.

Please see our response to question 4.

Vision & options

6. Do you agree that the four areas for reform are required? Please provide reasons for your position and evidence where possible.

We are broadly in agreement. We do however have concerns with moving decision-making away from industry completely. Under existing UNC Governance, the UNC Panel (the 'Panel') scrutinise modifications and make recommendations to the Authority. Where the impact of the proposal is limited, the outcome of the Panel vote becomes the decision, resulting in a more efficient outcome. Given the level of industry expertise within the Panel, we believe under any reforms, a Panel which is made-up of industry experts representing various constituencies including customer representatives, should still be consulted and involved in decision-making.

7. Do you agree with the two broad models outlined? Please provide reasons for your position and evidence where possible. – further detail can be found on each model in the chapters that follow.

We agree with the need for a model which includes the role of a code manager and strategic body.

8. Which model do you believe will best deliver on our desired outcomes? Please explain. NB: – further detail can be found on each model in the chapters that follow.

We believe Model 1: Code manager and a separate strategic body would better deliver the desired outcomes ahead of Model 2: Integrated rule-making body (IRMB). We have concerns around Model 2, with the IRMB having the power to set the strategy; ability to raise and develop change proposals; and the capacity to approve said proposal places too much reliance on one organisation and dilutes the checks and balances that would be a natural feature of Model 1.

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

Please see our response to question 6. We believe there can still be a role for code signatories, via Panel, to be involved in the decision-making process, given the level of industry expertise amongst panel members.

Providing strategic direction

10. Do you agree there is a missing strategic function for codes development in the energy sector and introducing a strategic function with the responsibilities outlined in chapter 3 is the best way to address the lack of strategic direction? Yes/No/Don't know. Please explain. Who is best placed to fulfil the strategic function and why?

We are in agreement that there needs to be greater coordination across codes. As we propose to retain the split in codes between gas and electricity, we support the creation of a bespoke overarching strategic function which code managers are accountable to. This strategic function would be well positioned to take a whole-systems view of the various codes and provide the strategic direction that would enable efficient and co-ordinated outcomes.

We believe a new independent body would be best placed to fulfil the strategic function. We do not agree with the expansion of the Electricity System Operator (ESO) due to its primary role as the national electricity transmission system operator with an inherent focus on electricity and limited experience of gas. This will inevitably lead to decision-making that may not adequately consider whole system solutions as the starting point will be based on what it understands and is familiar with.

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 are in agreement and do not have any additional comments at this time.

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

There will be consequential impacts on the licence obligations and codes of Gas Transporters and potentially other licensees. Ofgem will need to provide clarity on the licence obligations of all parties as misalignment between obligations and control will lead to inefficient processes and avoidable costs to consumers.

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 consider that there should be a formal mechanism in which the Government's vision is communicated to the strategic function body. The development of the strategic plan should be undertaken with extensive engagement, and therefore a strategy board should have representation from all relevant stakeholders

including industry and customers groups to ensure an adequate balance is achieved in decision making and prioritisation.

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)? Yes/No/Don't know. Please explain.

We are in agreement with the proposed scope of the strategic function. Widening the scope away from the industry codes framework may result in an unfocused strategic direction. Supporting other areas such as vulnerable customers is largely already catered for through licence requirements on suppliers and networks and through price control engagement and regulatory decision making.

Empowered and accountable code management & independent decision making

15. Do you agree that in addition to the current responsibilities that code administrators have, that a. 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. Yes/No/Don't know. Please explain.

a. identifying, proposing and developing changes (analysis, legal drafting etc.), including understanding the impacts – Yes, however code signatories should also have the ability to identify, propose and develop modifications to the extent they are aligned with and do not interfere or frustrate the overall strategic direction or prioritisation.

b. making decisions on some changes, or making recommendations to the strategic body – We still see a role for the UNC Panel or equivalent in the decision-making process, given the level of valuable industry expertise available. There also needs to be separation of the roles of proposer/developer and decision maker. It would not be appropriate for the proposer/developer to decide on implementation of their own modifications for reasons of good regulatory practice and governance.

c. prioritising which changes are progressed – Yes, so long as there is clear published guidance on the criteria for prioritisation that adequately balances the interests of customers, licensees and stakeholders.

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?

There are advantages and disadvantages to both integrated and separate functions. In gas there is clear separation between the code administrator (The Joint Office of Gas Transporters) and system manager (Xoserve) and this allows effective scrutiny by stakeholders of the performance of both organisations. Moreover, it reinforces the independence and impartiality of the code administrator which is valued by stakeholders. On the other hand, integration of roles may provide some efficiencies in decision making and planning. In either case, further discussion is required on the merits of each.

17. Should the approach differ on a case-by case basis (i.e. depending on the code or system in question)? Yes/No/Don't know. Please explain.

Please see our response to question 16 – further debate on the merits of an integration or separation are required and the requirements of electricity and gas may be sufficiently different to warrant varying solutions.

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? Yes/No/Don't know. Please explain.

We are in agreement that the code manager function should be accountable to the strategic body. We believe that learning should be taken from the Retail Energy Code (REC) to inform the most efficient approach in relation to licence or contract models. While a contract approach may encourage competitive and innovative bids, a licence could provide more stability and facilitate more flexibility.

Please note questions 19- 26 only apply in respect of Model 1 (code manager function and a strategic body).

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

We are not aware of more effective ways other than legislation although this would not provide the flexibility required to manage the increasing pace of change over the coming years.

20. Do you agree that we should not consider further a model whereby code managers are accountable to industry? Yes/No/Don't know. Please explain.

We believe it is critical that industry still have a role to play in the process, but full accountability as currently undertaken through the UNC panel for instance should be reviewed to ensure the balance of customers, licensees and other stakeholder interests are weighted appropriately. Effective decision making requires clear lines of accountability and therefore making the code manager accountable to both the strategic body and industry would need careful consideration.

21. Do you have views on whether the code manager function should be appointed following a competitive tender process or other competition? Yes/No/Don't know. Please explain.

We believe that a competitive tender process is an appropriate way of appointing a code manager. We do however acknowledge that due to the complexity and industry knowledge that is required in the role, there may only be a small number of organisations able to undertake the role and consideration should be given to utilising and incorporating the skills and experience of existing code entities.

22. Do you think the code manager function should be established by the strategic body creating a body or bodies? Yes/No/Don't know. Please explain. If the code managers were established in this way, would we need to consider any alternative approaches to funding or accountability? Yes/No/Don't know. Please explain.

As the code manager will be accountable to the strategic body, we believe the code manager function should be established by the strategic body. A levy on code signatories could potentially fund arrangements as currently applies in a variety of regulatory models.

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? Yes/No/Don't know. Please explain.

We believe that the new code manager function should operate without real or perceived undue influence from licensees. It would therefore be inappropriate for an existing licensee to become a code manager, or for licensees to create the function. Existing arrangements for example with the joint office of gas transporters where transporters are required through their licence to establish and fund the joint governance arrangements, while arguably very successful in providing a low cost/high value service are legacies of earlier industry developments. It is unlikely that anyone today would agree that such an arrangement was appropriate and this argument should extend to any licensee in relation to any code.

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? Please explain.

Price controls would be the most effective and transparent approach if accountability is achieved through a licence, whereas budget scrutiny would perhaps be appropriate if the contract route is selected.

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).

Parties would need to provide confidence, individually or in partnership, that they have the appropriate level of knowledge and expertise to undertake the role. As outlined in answer to question 23, there is an opportunity to reinforce the independence of code managers by removing the control of licensees.

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

Please see our response to Question 24.

Code simplification & consolidation

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

We are not aware of any quick wins, although if code consolidation is carried out separately in gas and electricity, it is likely to be much easier to consolidate the gas codes as there are fewer and follow similar conventions.

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

We are in support of Option C: Consolidated by fuel (gas and electricity). We believe there is a need for gas and electricity to remain as separate codes. Taking this approach would reinforce the need to weigh the merits of gas and electricity solutions from a whole system perspective. It would also enable comparison of best practice between vectors and therefore improve overall service delivery and foster innovation. We do not support a unified single code (USC).

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

We are in support of Option B: A different code manager per code. This would enable benchmarking the performance of code managers and foster expertise in the different physical characteristics of each sector to ensure efficient prioritisation and strategy development with the strategic body. Any concern around inconsistencies in the strategic direction of codes would be mitigated by an overarching strategic function across the two code managers.

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

We support the consolidation of codes and agree with the rationalisation; simplification and digitalisation of code, however believe this should be delivered in a phased approach as a suite of reforms.

31. Do you agree that the codes should be digitalised? Yes/No/Don't know. Please explain.

We are in agreement.

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?

We believe industry should support the code manager in identifying what compliance action should be taken in the event of a non-compliance with the code. This could be in the form of a Panel consisting of industry experts, with representation from all constituencies.

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

We believe Model 1 would better facilitate effective compliance monitoring. We do not support Model 2 as

we believe there should be a clear distinction between the strategic function and code managers to improve accountability and create challenge and effective scrutiny of performance.

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).

Please see our response to question 33.

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