



An Alternative for Industry Codes

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Summary

SSE is supportive of reform in the governance arrangements for Industry Codes. This paper proposes an alternative to the current industry code arrangements that govern the rules of the energy market.

The industry codes are no longer fit for purpose. They are overly complex, struggle to deliver strategic change and require significant resource to effectively engage. We are operating in an increasingly complex environment, both in terms of industry change and political scrutiny. There is more customer choice than ever before, with an increasing number of new entrant suppliers in the market. There is also greater potential for innovation, with the Smart meter roll out and new business models becoming increasingly prevalent. As a result, the energy market is far more diverse than it was in the past. The current framework has not been designed to cope with these changes to the market. We consider that this is the right time to consider strategic reform, to ensure the governance arrangements work as effectively as possible. Ultimately this will ensure that the market is agile enough to work well for its customers.

This paper is designed to stimulate further thinking and debate. We think that radical change may be needed to deliver the required outcomes. For this reason, we have proposed that the multitude of industry committees and panels should be disbanded and that a public body (potentially part of Ofgem) should set, oversee and enforce the rules for the energy market. This centralised approach should be designed to ensure an improved level of strategic coordination of code changes, leading to more efficient outcomes for the industry.

Background

The Industry Codes are multilateral agreements that define the detailed rules necessary to operate the various components of the gas and electricity markets. There are 11 main industry agreements that set out the market rules:

- Electricity
 - Grid Code
 - Distribution Code
 - Balancing and Settlement Code (BSC)
 - Connection and Use of System Code (CUSC)
 - Distribution Connection and Use of System Agreement (DCUSA)
 - Master Registration Agreement (MRA)
 - System Operator Transmission Owner Code (STC)
- Gas
 - Supply Point Administration Agreement (SPAA)
 - Independent Gas Transporters Uniform Network Code (iGT UNC)
 - Uniform Network Code (UNC)
- Dual Fuel
 - Smart Energy Code (SEC)

Each of the codes have slightly different arrangements with different responsible licensees, different powers for their code panels and different arrangements for establishing code administrators, who look after the day-to-day governance of the codes.

The problem

Under the lens of the Competition and Markets Authority (CMA) Energy Market Investigation, the industry code arrangements have been open to scrutiny and concerns have been raised in a number of areas:

- Multiple complex multilateral agreements that require significant resource to understand and comply with;
- Large number of panels, committees and workgroups involved in the assessment of change that require significant resource to engage with; and
- Change processes that are unsuited to delivering coordinated, significant or strategic change;
- Lack of incentive for industry to engage in change and cooperate with the Authority on the delivery of change; and
- Lack of coordination where change affects multiple agreements.

The remedies put forward by the CMA have included: making code administration a licensable activity; granting Ofgem powers to project manage or control the timetable for code modifications; and appointing an independent adjudicator to determine disputes on code modifications. At the same time Ofgem has proposed further reforms to code governance. These are to be welcomed and move the arrangements in the right direction.

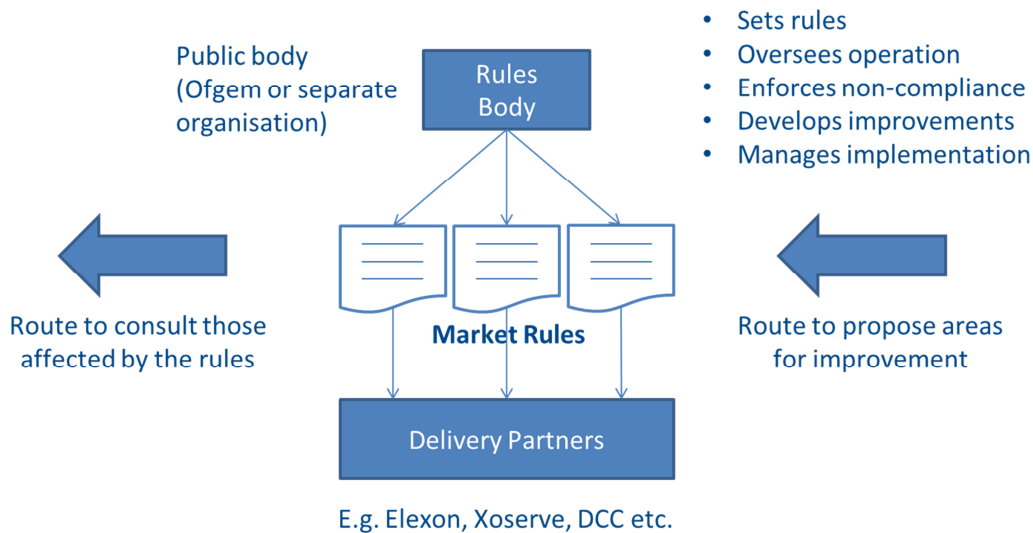
But do these proposals go far enough? If the codes do not work for industry or the regulator, then we need more fundamental reform rather than incremental amendments. A better approach may be to approach this with a blank piece of paper, and design an approach from the ground up, rather than trying to fix a design that is no longer fit for purpose.

An alternative

Ultimately we need to get back to the core purpose of the codes, and that it is not about modification rules, panels, workgroups, committees or code administrators. It is about setting the right rules to ensure the energy market operates effectively today and in the future.

Whilst industry will try to balance individual commercial interests against the interests of the consumer and the market as a whole, when setting the rules, this can only be effectively achieved if it is done with a view to the future and the strategic direction of the market. We do not believe that changing the current arrangements will get us to this outcome. Instead, a better outcome might be to establish an approach whereby the market rules set out in the codes are set by a public body, which has a statutory duty to promote the best interests of the customer and competition in market.

The below diagram sets out a possible structure for our proposed governance model:



Governance

Our proposal envisages that a new rules body would be established. It should be a public body that could either be part of Ofgem or be established as a separate organisation. It should have a clear remit to:

- Set the rules for the energy market (currently covered by the industry codes);
- Oversee the operation of those rules; and
- Enforce against companies where there is non-compliance with those rules.

Strategic direction

The new rules body would oversee all of the energy market rules and the question of the strategic direction becomes a lot easier to consider in the light of future market needs. In conjunction with the Government, the regulator and industry, one of the first tasks of the rules body would be to develop a strategic roadmap for the market rules taking into account:

- The needs of customers;
- Developing competition;
- Energy strategy and policy statements from government;
- Ofgem's future work plan;
- Future demands on the structure of the market; and
- Non-traditional business models.

The strategic roadmap, potentially covering periods of 5, 10 and 20 years, would be the basis of delivering major change to the market rules and its publication would give industry and the regulator a degree of certainty on the level of change.

Any strategic roadmap would need flexibility to cope with the unexpected and will need to be reviewed and republished on a periodic basis to ensure that the direction of the rules continue to align with the direction of the market.

This strategic roadmap, and any updates, would be subject to statutory consultation and be subject to an appropriate appeal route.

Changing the rules

Inevitably, once set, the rules will need to change to reflect the development of the energy market. It is crucial these changes move the market towards the strategic direction and deliver changes that matter for customers and competition.

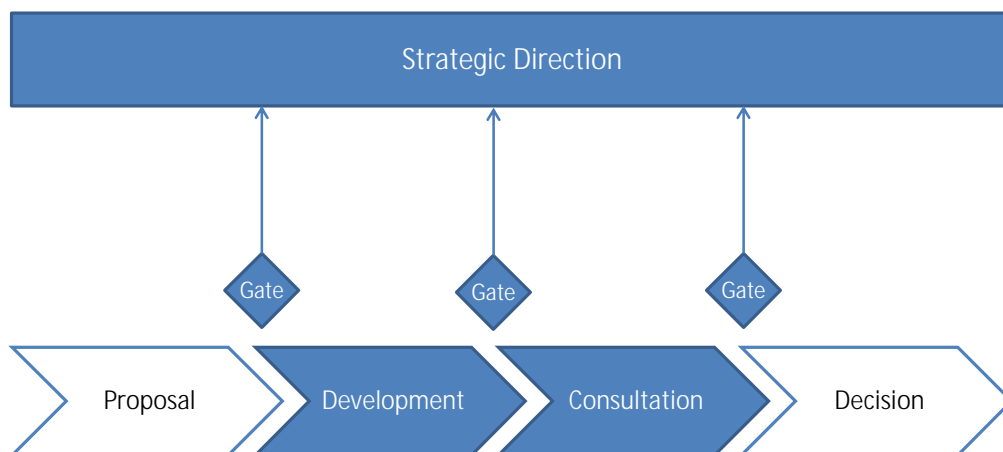
In the same way that new and amended licence conditions are proposed and consulted upon by Ofgem, the new rules body would propose, develop and consult upon amendments to the market rules. The rules body would assess any amendment against its objectives and the strategic direction to ensure that all but the most urgent of amendments continued to move the market towards its strategic goal.

In assessing amendments, the rules body would undertake detailed economic analysis of the proposal gathering evidences from industry, the regulator and government to support its conclusions.

The rules body would be able to receive proposals to amend the market rules from the regulator, industry and consumers. But rather than allowing all proposals proceed to development, the rules body would establish a gated process which would assess any proposal against the strategic direction before being accepted for further development.

Any proposal that deviates from the strategic direction would need a clear justification that it is fixes an issue in need of urgent resolution.

The rules body would undertake further “gate review” assessments against the strategic direction as the proposal is developed and at these review points may decide to discontinue the development of a proposal.



Like the current arrangements for changes to licences, the decisions by the rules body on an amendment to the market rules would be subject to appeal to the CMA.

Guidance

Currently, some of the codes produce guidance material but this is limited and does not cross code boundaries. With responsibility to oversee all of the market rules, the rules body would be able to produce guidance on the rules from the differing perspectives of industry companies, large users and consumers.

The guidance from the rules body should consist of advice and information to help companies understand and meet the obligations in the rules. This should include: case studies and, examples of good and bad practice.

Due to the complex nature of the energy market, even a set of rules under a single rule body would remain a complicated suite of documents. The rules body would produce summary guides for the rules that could point companies in the right direction.

Delivery partners

A number of organisations have been established to provide services to support or deliver the functions of the energy market. These include:

- Smart DCC – established under licence to provide communications and data services for Smart Meters, and expected to provide central registration services;
- Elexon – established by National Grid under its licence to provide electricity balancing and settlement services;
- Xoserve – established by Gas Transporters under their licences to provide gas settlement services; and
- Electralink – established by Electricity Distributors under their licences to provide a secure communications network for the electricity industry.

It is envisaged that these organisations will continue to provide services to the energy market and in some instances the current arrangements for these organisations may need to be adjusted. There may be an advantage of requiring each delivery partner to be subject to and comply with the market rules.