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Industry Code Governance: Initial consultation on implementing the Competition and Markets Authority's recommendations

Consultation

Publication date: 9 November 2016

Response deadline: 1 February 2017

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Overview:

The Competition and Markets Authority's (CMA) investigation into the GB energy market concluded that the code governance arrangements, which have existed in a similar form since privatisation, have a negative and material impact on consumers' interests and/or competition. The CMA recommended a package of remedies for code governance to support a coherent vision for strategic industry change led by Ofgem, and clearer accountabilities for delivering it by the industry.

This is our first consultation on implementing the CMA's recommendations for industry code governance. This consultation seeks views on what the scope of the new regulatory framework should be and how we should transition to it. It also sets out initial proposals for our strategic direction for codes, the consultative board and the licensing of code managers.

We are inviting stakeholders to respond to this consultation by 1 February 2017, by emailing responses to the address above. We will be holding a stakeholder workshop on 12 January 2017.

Context

Ofgem's principal objective is to protect the interests of both existing and future energy consumers.

Ofgem referred the energy market to the Competition and Markets Authority (CMA) in 2014, and on 24 June 2016, it published its Energy market investigation - Final report (CMA Final Report). This sets out a significant package of remedies to address areas, including industry code governance that it identified as giving rise to an adverse effect on competition.

We published our strategy for implementing all 26 CMA remedies on 3 August 2016 and outlined our approach and indicative timelines for delivering them. We are publishing our implementation plan of the CMA's remedies today. This document follows on from our strategy and contains more detailed implementation plans for each remedy.

Ofgem is committed to acting on the CMA's final recommendations. We are consulting specifically on implementing the code governance remedies.

Associated documents

- Ofgem, November 2016, CMA Remedies Implementation Plan https://www.ofgem.gov.uk/publications-and-updates/cma-remedies-implementation-plan
- Ofgem, August 2016, Response to the CMA's final report https://www.ofgem.gov.uk/system/files/docs/2016/08/response_to_the_cmas_final_report.pdf
- Ofgem, August 2016, CMA Remedy Implementation Strategy https://www.ofgem.gov.uk/system/files/docs/2016/08/ofgem_implementation_strategy.pdf
- Competition and Markets Authority, June 2016, Final Report https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf
- Ofgem, March 2016, Code Governance Review (Phase 3): Final Proposals https://www.ofgem.gov.uk/system/files/docs/2016/03/code_governance_review_phase_3_final_proposals_2.pdf

Contents

Executive Summary

A large suite of industry codes and central systems drive the day to day working of the industry. Consumers rely indirectly on these codes and systems for the outcomes they experience, for example when changing energy supplier. Currently bodies answerable to - and funded by - the industry run the codes and associated central systems.

The approach makes sense where only small scale changes are needed to keep the rules and systems fit for purpose and where the composition of the industry is homogenous and interests are largely aligned. However, the significant industry change that we anticipate in the years ahead calls this model into question.

New technologies, new business models and new ways of running the energy system are emerging. These innovations may help us move to a low carbon system that is both secure and affordable. They will also be important for enabling our vision for smarter markets where consumers are more engaged and empowered. But the existing industry code governance framework may be preventing these innovative ideas from coming to fruition, especially where they require significant changes to existing arrangements, and where they are not aligned with certain industry interests.

We agree with the CMA that the current arrangements have a negative and material impact on consumers' interests and competition. Like the CMA, we believe that the current system has been unable to handle the growing need for coordinated code change well enough. Last year we launched a major programme, in partnership with industry, to overhaul the switching arrangements and deliver faster, more reliable switching for energy consumers.

We are also taking forward work on mandatory half-hourly settlement. We are taking on this work because the current industry arrangements are not designed to bring about change of this magnitude in a timely way without our intervention.

What needs to change?

We think responsibilities and roles for delivering cross code changes in the industry will need to change to ensure that there are clearer accountabilities. We see an important and expanded role for code administrators. They were not set up to perform the role that is needed today, but the new framework will ensure they can deliver end to end strategic change in the interests of consumers, while continuing to provide services to the industry. We refer to this expanded role as a 'code manager'.

Our role must also adapt. In an ideal world, significant code change would be driven successfully by the industry under appropriate, but light touch, regulatory oversight.

Under the new arrangements we will set a coherent vision for strategic change and there will be clearer lines of accountability for delivering it. We will have a direct relationship with newly licensed code managers and delivery bodies, who will lead end-to-end code change in line with Ofgem's strategic direction.

Licences will set clear requirements and incentives for code managers to deliver strategic changes. We are considering how competitive tendering can play a role in ensuring value for money and enabling a transition to improved cross-code coordination.

Our objectives

In the near term, our overriding objective is for these remedies to achieve greater coordination across codes for identifying and delivering strategic change that benefits consumers and competition.

The changes recommended by the CMA support this objective and build on our code governance reform work so far.

The key changes we plan to put in place are:

1. **Licensing of code managers and delivery bodies:** We will design a new regulatory regime for code management and system delivery, considering a role for competition in driving benefits for consumers.

2. **Setting a strategic direction for code development:** We will introduce a new tool to provide industry with a coherent vision for change. This will set the parameters of the new arrangements, making sure effort and resources are focused on the industry changes that benefit customers most.

3. **Establishing and running a consultative board:** This new body will coordinate and prioritise cross-code change that benefits consumers. It will develop and help maintain a joint industry plan in line with the strategic direction.

This consultation firstly tackles the question of what the scope of the new regulatory framework should be (Chapter 2). This will allow us to set parameters for the existing industry codes and systems. It then goes on to tackle the key policy questions for the changes outlined above (Chapters 3, 4 and 5). Finally it considers how best to transition to the new arrangements with minimum impact on existing projects (Chapter 6).

Next steps

We want to make sure these remedies are practical, workable and operate in consumers' best interests. Input from stakeholders is critical to ensuring these remedies are delivered successfully. We will consider fully a range of implementation options before we decide on the right model.

We expect to make good progress during 2017 developing and implementing our strategic direction for codes and setting up the consultative board to help us deliver it, as these recommendations are not dependent on legislation.

The programme of work for the new licensing arrangements extends over a longer timeframe. This timing will be heavily dependent on legislation.

1. Introduction and context

Building industry systems and governance for the future

1.1. To operate effectively, the energy market depends on many complex industry codes and central IT systems and processes. These codes and systems affect the competitiveness of both the wholesale and retail energy markets. Consumers rely indirectly on these systems for the outcomes they experience, for example, a reliable process for switching supplier or accurate costs of generation allocated through settlement.[1]

1.2. These codes, systems and processes were put in place initially at privatisation during the 1980s and have evolved over time, particularly to reflect the increase in competition in the markets. However, with further developments including the introduction of smart meters and the transition to a low carbon economy, it is becoming clear that these codes and systems risk adversely affecting competition; either by distorting incentives, raising barriers to entry, or stifling the innovation that creates a smarter market that delivers better outcomes for consumers.[2]

1.3. The CMA's remedies in this area are designed to support a coherent vision for strategic industry change led by us, with greater accountability for those in industry delivering it. Changing the accountabilities of central system providers and code administrators, so that they are also accountable to us, acting on behalf of consumers, should ensure they deliver and maintain systems that work for consumers. The CMA's recommendations for future code governance are summarised in appendix 1.

Key outcomes for future code governance

1.4. The processes for the governance of the industry codes were designed to be industry-led. This is largely because industry participants have relevant information and can develop the codes according to the emerging needs more dynamically. In an ideal world, even significant code change would be driven successfully by the industry under appropriate, but light touch, regulatory oversight.

1.5. Our overriding objective for these remedies is to achieve greater coordination across codes for identifying and delivering strategic change that benefits consumers and competition. Putting in place the right governance framework should allow industry to deliver change more effectively with the appropriate level of oversight from us. Once the new regulatory framework is in place, we expect it to deliver these three outcomes:

1. A coherent vision for strategic change led by us and clearer lines of accountability for delivering it.

[1] Settlement reconciles discrepancies between a supplier's contractual purchases of electricity or gas and the actual demand of its customers. A key aspect is identifying how much consumers use in each half-hour.
[2] Para 19.295 CMA Final Report.

2. A system of code governance that allows strategic change to be delivered smoothly, efficiently and in the interests of consumers. This remedy can potentially speed up delivering benefits to consumers and competition through changes to relevant industry codes that implement government and Ofgem's policy objectives.
3. A clear, ongoing signal for industry on where to deploy resources.

1.6. To achieve these outcomes, industry participants' roles and responsibilities will need re-setting. In particular, the role of existing code administrators will need to change. The new arrangements will include creating new licensed entities to act as 'code managers', a role which will build on and go beyond the existing code administrator role. The code managers for the various codes will be responsible for ensuring cross-code change is delivered efficiently for their code. It will also mean changes to Ofgem's role on the strategic direction of codes.

New roles and responsibilities

Code managers

1.7. The current role of the code administrators will not be adequate to enable future industry change to be implemented in the most economic and efficient way. We believe this is a problem that requires re-alignment to plug a gap in current roles and responsibilities.

1.8. Code administrators are an administrative or secretariat body appointed by the industry (as required under relevant licence conditions) to manage the processes and functions set out within each code. This includes administering the process for changing the codes and acting as a 'critical friend', providing support and advice to code parties on the change processes, as required by the Code Administration Code of Practice (CACoP). Throughout this document, we have used the term code manager to refer to the expanded role of code administrators that will be an essential part of the new regulatory framework.

1.9. New roles and responsibilities will be assigned to a new set of licensed organisations under future arrangements. These organisations will continue to play a role in 'administering' codes, but will also take on new responsibilities for ensuring progression of code change under the licences that we will introduce. So that everyone is clear about who is responsible for developing the code, we may also consider including the requirement that code managers become the code owners, eg having a licence obligation on the code manager to have the relevant code in place.

1.10. The newly-licensed code managers will play an essential role in ensuring effective code change in the future. Code managers will effectively lead code change in line with Ofgem's strategic direction. As a result, code managers will be required to work together with industry participants to consider how code modifications can be most effectively prioritised in order to achieve the outcomes set out in the strategic direction. Chapter 2 explores which codes we should introduce a licensed code management function for.

Delivery bodies

1.11. Those organisations that are responsible for running the central systems and processes that underpin the codes will play an important role in the new framework. Delivery bodies will be responsible for ensuring effective implementation of code change, by delivering central system changes and coordinating with other system changes where

necessary to implement cross code change effectively. Chapter 2 explores the case for licensing the current range of delivery body functions.

Code parties

1.12. Code parties[3] will also have to change how they engage in new processes, and help code change to progress. While not all code parties are licensed, we note that a broad range of existing licensed bodies take an active role in the development of code modifications. We expect changes to the licences of these code parties will be needed to facilitate the new roles and responsibilities in the new regulatory regime.[4] Such changes could include requirements placed on licensed code parties to assist in ensuring timely change in line with the strategic direction.

Code panels

1.13. Each industry code has a group of (often elected) industry representatives, as well as a number of other parties, including consumer bodies and Ofgem (in an observer role) which form a panel. The panels have a range of responsibilities set out in each particular code, including responsibility for assessing proposals to modify the codes and, where changes have a material impact on competition and/or consumers, making a recommendation to us on whether to approve or reject the change.

1.14. The balance of responsibilities and relationship between code panels and code managers may need to adapt to deliver the desired benefits of the new arrangements. When we consider the functions and incentives that fall upon code managers, we will also need to consider the process that modifications go through, including how code panels fit into this.

Ofgem

1.15. There will be new requirements and challenges for us as well. For example, we will develop our ongoing strategic direction, and play a key role on the consultative board. The new code managers and delivery bodies will be more clearly accountable to us via licence obligations to deliver the strategic direction for codes. We might also require code parties to cooperate with code managers in developing code change through strengthened licence conditions. This means new or altered relationships via licences, and clear accountabilities for delivering in the interests of consumers. And, where appropriate, incentives will be put in place to deliver those outcomes.

1.16. The CMA also recommended that the Department for Business, Energy and Industrial Strategy (BEIS) enact legislation to provide us with new call-in powers.[5] If the new framework is successful, we do not envisage the call-in powers to be needed frequently.

[3] This is a collective term for all market participants and any organisation engaged, or wishing to engage, in the activities covered by the industry codes. In respect of the Grid Code and the Distribution Code the definition used is code users which we encompass within our code parties definition from this point onwards.
[4] In some cases, this will include the removal of licence obligations in respect of having codes in place.
[5] This would provide us with the ability to intervene to 'call in' an ongoing strategically important modification proposal in the event of the occurrence of certain exceptional circumstances.

However, they are a necessary option, which will be used only in exceptional circumstances, where there is good reason to expect that the new industry led arrangements cannot deliver, or have not delivered, the necessary change.

Our programme of work

1.17. Our programme of work will include three work streams. We expect to make good progress during 2017 developing and implementing our strategic direction for codes and setting up the consultative board to help us deliver it.

1.18. The programme of work for the new licensing arrangements extends over a longer timeframe. We currently anticipate that we will be in a position to grant the first licences in late 2019. These timeframes are indicative only, as they depend in large part on the legislative processes and parliamentary timescales BEIS is subject to. There is a summary of our indicative timeline to implement the code governance reforms in appendix 3.

Work stream 1 – Licensing and competition

1.19. Licensing is an essential way to achieve benefits for consumers while re-balancing the roles of Ofgem and code managers as well as delivery bodies. By setting clear requirements and incentives on code managers and delivery bodies to deliver strategic change, we will be less involved in the detailed development of code changes allowing us to devote resources more effectively and efficiently. Using competition to appoint code managers should add further benefit by ensuring the body best placed to deliver the functions required can do so.

1.20. In this consultation, we look at the scope of the codes that we consider should fall within the licensing arrangements (chapter 2) and how licences will be awarded (chapter 3). Our work programme includes developing the outputs that code managers and delivery bodies will be required to deliver, as well as the incentives in place to ensure that they do so. Finally, we will develop our approach to competitively appointing code managers and delivery bodies.

Work stream 2 – Setting the strategic direction for codes

1.21. The strategic direction will play a central role in aligning industry objectives with Ofgem's focus on consumer interests. It will ensure all participants active in industry codes are working towards the same goal.

1.22. This work stream will initially consider what it should contain and what the responsibilities of stakeholders should be. We expect the initial strategic direction to develop iteratively, and will have a draft by late 2017. Chapter 4 contains further details. Longer term, we will consider whether changes to licences or industry codes are necessary to deliver the strategic direction alongside development of the licences for code managers.

Work stream 3 – The consultative board

1.23. The consultative board will play a pivotal role in the effective delivery of cross-code change that benefits consumers. It will ensure the coordination of change across all codes by developing a joint industry plan in line with the strategic direction. We expect this to be an iterative process for the initial plan, using the existing forward work plans of each code manager as its starting point. Once a steady state is achieved, the strategic direction will drive the consultative board, which in turn should drive the joint industry plan.

1.24. This work stream will initially consider the role and remit of the board, before going on to consider the board's terms of reference, composition and funding. We anticipate the board holding its first meeting in early 2018. Chapter 5 contains further details.

What is in and out of scope

Code and code manager/delivery body consolidation

1.25. We recognise the longstanding issues around the complexity, length and number of codes. We also understand that there are differing views amongst stakeholders on this, and whether and how such issues could be addressed. We agree with the CMA that code consolidation may be a beneficial longer-term outcome from introducing improved code governance arrangements, rather than a key initial objective.

1.26. At the same time, there are ongoing projects, such as the switching programme and half-hourly settlement, which may result in potentially significant changes to the structure of the codes. Code consolidation will not be in the direct scope of our project and neither will we bring projects such as the switching programme, which may consider new code structures, into scope. But, we will follow these developments to make sure the arrangements we put in place for licensing of code managers are appropriately structured. For example, if new codes arise from the projects currently in progress, we will consider whether they fall within the scope of our arrangements and require a licensed code manager and delivery body.

1.27. Without consolidating the codes themselves, code managers and delivery bodies could be consolidated given the opportunities for them to take on responsibilities for more than one code. This may help make governance more consistent and coordinated, and could in turn lead to consolidation of the codes themselves.

1.28. As we develop a competitive regime for licensed code managers and delivery body roles, we may want to facilitate consolidation of these bodies through our competitive approach. We will consider where consolidating roles may provide benefit and may iterate this consolidation over repeated periodic tenders. For example, we may compete for one code manager role across two codes where we identify sufficient synergies between them.

Code manager and delivery body business models

1.29. Currently, the requirement to have a code administrator in place is set out within the licence of one or more industry participant(s). However, the governance and business structure/ model of the code administrators take a variety of formats.[6]

1.30. We must ensure that those bodies that are awarded licences are fit for purpose to deliver the outputs set for them. If they can demonstrate they are able to deliver such outputs, we want there to be as many bodies as possible competing to provide a code management service. This could include new bodies as well as incumbent code

[6] There are currently changes being discussed regarding the governance structures of both Elexon and Xoserve. We consider that these proposed changes are consistent with the direction of travel discussed in this document, as they will result in the strengthening and clarification of the organisations accountability towards industry.

administrators and delivery bodies. We will be open to considering code and licence modifications where necessary to facilitate an open and effective competitive process.

Legislative requirements and the role of BEIS

1.31. In addition to the recommendations made to us, the CMA made recommendations to the government to introduce legislation to make code administration licensable and to grant us powers to make code modifications in exceptional circumstances (the call-in powers).

1.32. Thus, much of the content included in this consultation will ultimately depend on BEIS's policy development and final legislative text. For example, the scope of the licences, which the new framework covers, will be set through legislation, as will the processes surrounding how that scope is amended to reflect developments in the industry.

1.33. We will continue to work closely with BEIS as we develop policy. Where legislation is required to implement code governance policy, we will use responses to this consultation to inform our recommendations, which we will then feed into the BEIS legislative programme.

Next steps

1.34. We welcome your views, which we will consider as we develop and implement these reforms in 2017. Please respond to this consultation by **1 February 2017**. All responses should be sent to Code Governance Remedies, Ofgem, 9 Millbank, London SW1P 3GE or by email to CodeGovRemedies@ofgem.gov.uk. Any responses that you do not wish to be published should be marked as confidential. Further information on how to respond to this consultation is on this page.

1.35. We will host a stakeholder event during the consultation period to discuss our proposed approach and gather views. This will be on 12 January 2017. If you would like to attend, please contact CodeGovRemedies@ofgem.gov.uk. Further information on the event is can be found here.

2. Scope of the new arrangements

Chapter Summary
This chapter discusses the scope of the CMA's code governance recommendations. It considers which current codes and delivery functions could be within scope of the new arrangements.

Question box

Question 1: Do you agree that the codes and functions we have identified (ie. 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?

Introduction

2.1. Our overriding objective for these remedies is to achieve greater coordination across codes for identifying and delivering strategic change that benefits consumers and competition. The strategic direction (chapter 4) will play a central role in achieving this objective, but will need to be supported by the new code management licensing regime[7] which will introduce greater accountability in the delivery of strategic change.

2.2. The CMA did not recommend which codes these remedies should be applied to. They considered that BEIS and Ofgem are in a better position to define the scope.[8] However, they made reference to those codes currently covered by the CACoP.[9] These codes are our starting point in the following analysis. We consider additional possibilities below, and other codes and functions not referenced may also be relevant.

2.3. The final scope of the arrangements will be dependent on the policy approach taken by BEIS in introducing the necessary legislation. Thus, responses to this consultation will be used to develop a recommendation to BEIS on the legislation that they are developing.

Application to codes and delivery functions

2.4. This section discusses each code and function in turn, including the benefits and drawbacks of including them within a new regime. Some examples of the factors that we consider to be important in considering the scope of the new arrangements are set out below.

[7] Chapter 3 discusses how we propose to licence the codes and functions that we decide are in scope.
[8] Para 19.381 of the CMA Final Report.
[9] https://www.ofgem.gov.uk/licences-codes-and-standards/codes/industry-codes-work/code-administration-code-practice-cacop

- **Accountability** - This takes into account how many code owners[10] there are. One of the aims of this remedy is improve accountability of code change. Therefore, where applicable it would be beneficial to ensure there is a single line of accountability between the code manager and Ofgem (and essentially the consumer).
- **Strategic change** - Whether the code has scope to materially impact the delivery of strategic change (ie changes that implement government and Ofgem policy objectives which aim to deliver benefits to consumers and competition).
- **Volume and scale of change** - This assesses not only the volume of modifications for each code, but also the impact that the modifications have on each code (eg how wide-ranging the modifications are, the resource impacts they have when being assessed and how wide-ranging the response from industry has to be to implement appropriate change).
- **Scope of code** - This assesses how much each code covers as well as how wide its influence reaches, especially when considering consumer impacts.

2.5. Table 1 groups the codes and delivery functions into five broad categories we consider are appropriate to aid comparison (although we recognise there are alternative ways the different codes could be grouped).

Table 1: Grouping of codes and delivery functions

*National Electricity Transmission System Operator

1	2	3	4	5
NETSO* codes	Non-NETSO codes	Other codes, agreements and standards	Central System Delivery Functions	Wider delivery Functions
CUSC GC STC	BSC MRA DCUSA DC SEC UNC SPAA iGTUNC	All those currently outside the CACoP eg SQSS	System delivery of: SEC (DCC Service) UNC BSC	Other system delivery functions eg DTS

2.6. All the codes in the Groups 1 and 2 above are within scope of the CACoP. The CACoP was developed by industry under our Code Governance Review[11] project, with the aim of making code modification processes more convergent and transparent, and to help protect

[10] A code owner is a licensee who has an obligation in their licence to have this code in place.
[11] Our Code Governance Review (CGR) was launched in November 2007 and aimed to improve the code governance arrangements and reduce fragmentation. The CACoP was developed under the first phase of CGR which concluded in 2010, and initially covered the BSC, UNC and CUSC. Under the second phase of CGR, which concluded in 2013, we extended the scope of CACoP to include the other industry codes.

the interests of smaller market participants and consumers through adopting key code administration principles. There are licence conditions on the code owners to have a code administrator in place that has regard to these principles.

Group 1 – NETSO Codes – CUSC, GC, STC

2.7. We have included in Group 1 ('The National Electricity Transmission System Operator (NETSO) codes') the electricity codes for which National Grid Electricity Transmission Plc (NGET) is the code owner.[12] Separate to its role as the code owner, NGET has also set itself up to be the code administrator for all three.

2.8. The **CUSC** (Connection and Use of System Code) has a broad scope and sets out the contractual framework for connecting to and using the national electricity transmission system (NETS). It also contains charging methodologies used to derive charges that NGET levies for connecting to and using the NETS. Modifications to the CUSC can have important and far reaching impacts. For example, strategic work, such as our work on the flexibility of the electricity system[13] may require modifications to the CUSC, as well as to other codes, being raised.

2.9. The **GC** (Grid Code) also has a broad scope as it contains all material technical aspects relating to connections to, operation of, and use of the NETS. Currently only NGET can raise a modification to the GC.[14] There are fewer modifications for this code than the CUSC but it too is affected by current strategic projects such as implementing the electricity European Network Codes (ENCs).[15]

2.10. The **STC** (System Operator – Transmission Owner Code) sets the roles and responsibilities of the NETSO and each Transmission Owner (TO) with regard to the planning and operation of the NETS. It includes arrangements for TOs to make transmission services available to NGET for its use so it can discharge its obligations as System Operator. It also includes arrangements for planning transmission outages and coordination of investment planning for the development of the transmission system. Because of its links with other codes, especially the GC and the CUSC, we consider its scope is broad. The STC does not change very often, but changes to it can have a significant impact on important issues relating to delivering and operating the electricity transmission networks. It has been impacted by strategic change in the past, for example implementing the offshore transmission regime, and is likely to be impacted in the future, regarding competitively appointed transmission owners.

[12] The STC is owned jointly by NGET, Transmission Owners and Offshore Transmission Owners.
[13] https://www.ofgem.gov.uk/electricity/retail-market/market-review-and-reform/smarter-markets-programme/electricity-system-flexibility
[14] There is currently a modification seeking to change GC governance, among other things by allowing parties other than NGET to raise modification proposals to the GC: http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/Grid-code/Modifications/GC0086/
[15] The European Network Codes are a legally binding set of common technical and commercial rules and obligations that govern access to and use of the European energy networks.

2.11. In summary, the CUSC, GC and STC all have the scope to impact delivery of strategic projects and as such we consider **all three within the scope of the strategic direction, consultative board and new licensing arrangements**. We note that Government is currently considering the case for greater independence of the system operator, working together with ourselves and NGET. We will take account of the outcome of that work in developing our approach to these codes.

Group 2 – Non-NETSO codes – BSC, MRA, DCUSA, DC, SEC, UNC, SPAA, iGTUNC

2.12. Group 2 codes are both electricity and gas codes. They are administered by several different bodies, none of which is NGET. Aside from the BSC (which is owned by NGET) and the SEC (which is owned by the DCC), they are all owned by multiple bodies.

Electricity Codes

2.13. The **BSC** (Balancing and Settlement Code) is a broad code which contains the rules and governance arrangements for the electricity balancing and settlement arrangements. It is currently owned by NGET under standard licence condition (SLC) C3 of its electricity transmission licence. Under this condition, NGET has an obligation to establish a Balancing and Settlement Code Company (BSCCo). One of the functions of the BSCCo is to administer the BSC. Elexon, a not-for-profit company established by and kept at arm's length from NGET, is the BSCCo and therefore is the code administrator of the BSC. Even though there are usually few live modifications at any one time, these modifications generally have a wide impact on the market and many industry parties. Current strategic projects, such as the switching programme[16] and our work on half-hourly settlement,[17] have a significant impact on the BSC. As mentioned above with the NETSO codes, any approach to this code will need to be alive to any work considering the role of the system operator.

2.14. The **MRA** (Master Registration Agreement) has a broad scope as it provides a governance mechanism to manage the processes established between electricity suppliers and distribution companies to enable electricity suppliers to transfer customers. It also includes terms for the provision of Metering Point Administration Services Registrations. Responsibility for the Data Transfer Catalogue (DTC)[18] sits under the MRA. It is owned by the distribution network operators (DNOs) under SLC23 of their distribution licence, and is currently administered by Gemserv under a commercial contract with MRASCo Ltd.[19] Given its important role in facilitating the change of supplier process, it has scope to have a significant impact on the delivery of strategic change. Changes to the DTC are often important for implementing BSC changes giving important cross code dependencies.

2.15. The **DCUSA** (Distribution Connection and Use of System Agreement) is a broad code which provides a single centralised document relating to the connection to and use of the

[16] https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/smarter-markets-programme/switching-programme
[17] https://www.ofgem.gov.uk/electricity/retail-market/market-review-and-reform/smarter-markets-programme/electricity-settlement
[18] The DTC accommodates the inter-operational exchange of information enabling effective interface between industry participants.
[19] A company owned by all MRA parties.

electricity distribution networks. It includes the charging methodologies for such connection and use. It is owned by the DNOs under SLC22 of their distribution licence, and is currently administered by Electralink under a commercial contract with DCUSA Ltd.[20] The information in the DCUSA is vital for the effective and efficient running of the distribution systems and so can affect, and can be affected by, any strategic change.

2.16. The **DC** (Distribution Code) is a broad code, which covers the technical aspects relating to the connection and use of the electricity distribution licensees' distribution networks. It specifies day-to-day procedures that govern the relationship between a distribution licensee and users of its distribution system for planning[21] and operations in normal and emergency circumstances. It is owned by the DNOs under SLC21 of their distribution licence and is administered by the Energy Networks Association (ENA), a trade body owned by the DNOs. Currently, only the DNOs can raise modifications to the DC and there have historically been relatively few changes to the code. However, it has scope to impact delivery of strategic change for networks - for example, changes required to implement the electricity European Network Codes. There is also considerable scope for cross code interactions between the DC and the GC.

Dual Fuel Code

2.17. The **SEC** (Smart Energy Code) is currently the only dual fuel code. It sets out the terms for the provision of the Data Communication Company's (DCC) services and specifies other provisions to govern the end-to-end management of smart metering in gas and electricity. It came into force under the Smart Meter Communication licence which was granted to Smart DCC Ltd by the Secretary of State following a competitive licence application process in 2013. Chapter 22 of that licence requires that the Smart Energy Code Company (SECCo), owned by SEC parties, provides the code administration for the SEC. It does this via a commercial contract with Gemserv. Considering the direction the energy markets are moving (ie. with the roll-out of smart meters), this code could play a very important role in the delivery of large-scale strategic reform in the future.

Gas Codes

2.18. The **UNC** (Uniform Network Code) underpins the operation of the competitive gas industry, comprising a legal and contractual framework to supply and transport gas. It has a common set of rules which are aimed at ensuring that competition can be facilitated on level terms. It governs processes, such as balancing the gas system, network planning, and allocating network capacity. It is owned by the gas transporters (GTs) under standard special condition A11 of the gas transporter licence. It is administered by the Joint Office of Gas Transporters, a body set up by the GTs. It is the largest of all the single fuel codes and covers the equivalent of several of the electricity codes. It is currently being impacted by

[20] A company owned by all DCUSA parties.
[21] DNOs are required by SLC24 of the distribution licence to plan and develop their network in accordance with a standard not less than that set out in Engineering Recommendation P.2/6. P.2/6 forms part of the Distribution Code and is, broadly speaking, the distribution equivalent of the (planning aspects of) the SQSS, discussed later in this chapter.

large-scale strategic reform of Project Nexus[22] and will be impacted again through other strategic projects such as the Switching Programme.

2.19. The **SPAA** (Supply Point Administration Agreement) sets out the inter-operational arrangements between gas suppliers and transporters in the UK retail gas market. It is owned by domestic gas suppliers under SLC 30 of their licence, and is currently administered by Electralink under a commercial contract with SPAA Ltd.[23] The SPAA was created to provide governance for those supplier-to-supplier procedures not ordinarily covered by existing contracts or agreements, but nonetheless considered important to the effective and efficient transfer of consumers between suppliers. It therefore has an important role to play in the change of supplier process and so is heavily impacted by the Switching Programme.

2.20. The **iGTUNC** (independent Gas Transporters Uniform Network Code) was implemented on 1 May 2007 to streamline and harmonise the network code arrangements of the iGTs as much as possible. It is owned by the iGTs under SLC 9 of the gas transporter licence, and is administered by Gemserv under a commercial contract with the iGTs. It has similarities with the UNC, and many of its changes mirror those of the UNC, but it also contains some provisions that are not covered in the UNC. As with the UNC, due to the wide ranging role it plays, it may be affected by strategic change although on a smaller scale.

2.21. As described above, all eight non-NETSO codes have the potential to play a material role in delivering strategic changes to the energy market and we therefore **consider them to be within the scope of the new arrangements.**

Group 3 – Other codes, agreements and standards – All those currently outside the CACoP

2.22. There are many other codes, standards, agreements and codes of practices in the energy market that could arguably come into the scope of the new arrangements. However, because their scope is narrow [24] it may be less likely they would materially impact the delivery of strategic change and so it may not be appropriate to bring them into the scope of the new arrangements.

2.23. The **SQSS** (System, Security and Quality of Supply Standards), however, stands out from the others in Group 3 because of its wide-ranging impact. It is a set of minimum technical standards that TOs and the SO must adhere to when planning and operating transmission systems. The SQSS is not modified very often. The current process for changing it is administered by NGET, and modifications are given effect through a licence change.[25]

[22] A project involving the replacement of the UK Link system (a system operated by Xoserve for energy settlements, supply point administration and other functions for the GB gas market).
[23] A company owned by all SPAA parties.
[24] For example, the Smart Meter Installers Code of Practice (SMICoP) which just specifies the minimum standards to follow in relation to the customer facing aspects of the installation of smart metering systems.
[25] SLCs C17, D3 and E16 of the transmission licence all refer to a specific version of the SQSS and so must be amended to reflect the correct version of the SQSS if this changes.

2.24. It is true that the SQSS has scope to impact delivery of future strategic change. However, the nature and scope of these highly technical standards is intrinsically linked to the core functions of TOs and SOs in planning and operating the high voltage electricity system, supporting their wider licence and statutory requirements to operate an economic and efficient system. The current licensees who must adhere to these standards should be well placed to be held accountable for driving forward and delivering change to these technical standards, including where this is necessary to support strategic change. Our current view is that it is unlikely there will be a strong case to bring SQSS into the scope of the new arrangements.

2.25. In summary, **we do not see a strong case for bringing this group within scope of the new arrangements.**

Group 4 – Central system delivery functions – System delivery of: SEC, UNC, BSC

2.26. We agree with the CMA's assessment that the Adverse Effects on Consumers (AEC) it has identified applies not only to the development of modifications up until their approval, but also to the implementation of modifications into central industry systems. We therefore propose to apply the CMA's remedies to both the code management and system change phases of the process, where this exists.

Smart metering central systems delivery

2.27. We recognise that the rules and requirements for service delivery are under the **SEC**, and there is already a single line of accountability from the DCC to Ofgem for these via a licence. Therefore the benefits of licensing the secretariat and administration functions separately may not achieve the end-to-end delivery of code change that the CMA recommended. That said, the SEC will play an important role in supporting cross-code change in future and therefore there will be benefits of the SEC being included in the new arrangements. We will consider the most appropriate approach as our thinking develops.

Gas central systems delivery

2.28. The core central system delivery function for a range of systems underpinning the gas industry arrangements (including those contained in the UNC) is currently undertaken by **Xoserve**. The licence requirements to have in place the UNC, and the related systems delivery 'agency' arrangements, are in the licences of the relevant GTs.[26] This means accountability for gas industry central system delivery rests with licensees whose core function is gas transportation rather than systems delivery. This can impact driving forward large-scale strategic change, as the interests of the licensees to whom Xoserve is accountable, may not always be aligned with the interests of those parties making use of these critical services and systems.

2.29. We have already undertaken extensive work with industry seeking to address this issue. Our review of Xoserve's funding, governance and ownership arrangements was driven, among other things, by industry's concerns that Xoserve remains fit for purpose and provides the required responsiveness and flexibility in the context of future gas industry

[26] The relevant GTs are the Distribution Network Operators as well as National Grid Gas Plc.

changes. We expect the new Xoserve funding and governance arrangements to be fully in place by April 2017. These new arrangements will improve accountability through a combination of measures aimed at increasing engagement and transparency of decision making, and through new funding arrangements through which users will pay Xoserve directly for the services they provide.

2.30. We consider that these new funding and governance arrangements for Xoserve are a step in the right direction; improving accountability should drive effective performance in delivery of these essential systems. We consider these reforms will drive the right outcomes for customers of Xoserve and ultimately benefit gas consumers.

2.31. The CMA's proposed remedies provide an opportunity to further build on the beneficial reforms the industry are already implementing, providing the opportunity to more directly align accountability for delivery in this area with consumers' interests. Given how critical the services and systems provided by Xoserve are across the whole of the gas industry, we think there is significant merit in including this core systems delivery function within scope of the new arrangements. We think this could deliver even further beneficial reform; ensuring strategic change is delivered smoothly, efficiently and in the interests of consumers.

Electricity central systems delivery

2.32. The core central system delivery function for systems underpinning the electricity industry balancing and settlement arrangements is undertaken by **Elexon**, alongside their role as Code Administrator for the BSC. As noted above, while Elexon is wholly owned by NGET, they are operated on a deliberately arms' length basis.

2.33. Following an independent review of Elexon's governance, the industry developed a number of changes to the BSC (under modification proposal P324[27]) aimed at improving Elexon's accountability. We recently approved P324, which will, among other things, more clearly defined the roles of the Elexon Board and BSC Panel, and provide for greater accountability to BSC parties by enabling parties to vote to approve and remove directors. We set out in our decision that we consider these reforms are an improvement to the current arrangements, and in the same direction of travel as the CMA's recommended code governance remedies.

2.34. However, as with the beneficial reforms under the gas industry governance arrangements, the CMA's proposed remedies provide an opportunity to further build these reforms, aligning accountability more directly with consumers' interests. The systems Elexon is responsible for are critical in ensuring effective functioning of the electricity market arrangements under the BSC, and can have a significant impact on delivery of strategic change. Because of this, we think that this system delivery should come into the scope of the new arrangements.

2.35. In summary, **we consider the three core delivery functions discussed in this section should be within the scope of the new arrangements**.

[27] https://www.elexon.co.uk/mod-proposal/p324/

Group 5 – Wider delivery functions – Other system delivery functions

2.36. There are additional systems delivery functions which could potentially fall within scope of a licensed delivery body. Group 5 could include the Data Transfer Service (DTS), the Theft Risk Assessment Service (TRAS), ECOES or MPAS for example.

2.37. It seems unlikely that these other system delivery functions will materially impact the delivery of strategic change and so it may not be appropriate to bring them into the scope of the new arrangements. Some are already within the governance of the current codes (eg TRAS is within SPAA) and so, through greater accountability which will come from the introduction of the new licensing regime, will be brought into scope by these codes.

2.38. However, systems like the DTS (which plays an important role in processes such as change of supplier) may benefit from being within the scope of the strategic direction and the consultative board – this would help to ensure a more joined-up and efficient change process.

2.39. **We are open to views** on whether any of the wider delivery functions should be within the scope of the new arrangements.

3. Licensing and Competition

Chapter Summary
This chapter discusses the possible approaches to licensing code managers and delivery bodies and the role of competition.

Question box

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?

Introduction

3.1. The CMA recommended that BEIS should make the provision of "code administration (and delivery) services" a licensable activity.[28] This was designed to ensure that we have appropriate sight of all relevant code development issues so that we can exercise our discretion to intervene in the most effective manner. The CMA said that it is necessary to establish a clearer role for code managers and delivery bodies by licensing those entities and codifying their powers and responsibilities. The previous chapter set out the considerations that we believe should be taken into account in defining which codes the CMA's recommended licensing provisions should apply to. This chapter outlines the possible approaches to licensing code managers and delivery bodies.

3.2. In addition to its recommendation to make code administration a licensable activity, the CMA noted that a benefit of licensing is to "open up the market for code administration (and delivery) services to full competition"[29] (but did not make this a formal recommendation). We consider where a competitive process could be used and some limitations to this.

3.3. As with defining the scope of the arrangements, the form of licensing and competition will be dependent on the policy approach taken by BEIS in introducing the necessary legislation. Thus, as with the scope of the arrangements, responses to this consultation will be used to develop a recommendation to BEIS on the legislation that they are developing.

3.4. The CMA identified end-to-end delivery of code change as the driver of its AEC. The problem that the CMA identified extended to the delivery of systems changes to bring those modifications into effect.

[28] Para 19.395 of the CMA Final Report.
[29] Para 19.387 of the CMA Final Report.

3.5. There are both synergies and potential for conflicts of interest between a code management and delivery body role. By considering the difficulty of system design at the time of developing the modification, an integrated code management and system delivery role can help to ensure that costs of system development are factored into any cost-benefit analysis, and that realistic timing expectations can be set for delivery of change. However, without careful design of incentives, this also has the potential to lead the code manager to promote a certain solution because it may be easier to introduce through system changes under its delivery body responsibilities even if the chosen solution is sub-optimal.

3.6. We consider the synergies between the code management and delivery element of code change to be sufficiently strong that we consider that a single licence should cover the full end-to-end delivery responsibilities (both code management and systems delivery). We consider this the most effective way to tackle the CMA's identified AEC relating to end-to-end delivery of code change. Under such an arrangement, the licensed entity may have the choice of whether to take on the system delivery responsibilities itself or put in place contractual arrangements with a third party, but the responsibility under licence would remain with the code manager.

3.7. In following this approach we consider it important that we minimise the risk of conflicts arising. We intend to do this through carefully designing the licence requirements and incentives placed on the licensed entity to take on responsibilities for both code management and system delivery.

3.8. We do not think it would be beneficial to have more than one licence for code managers in place for any one code (eg, there would only be one licence in respect of the BSC, SEC, UNC, etc) at any time (other than possibly in the case of handover periods).

The role of competition in the licence award process

3.9. We think there are benefits that competition could bring to the licensing regime for code management and system delivery. It could:

- drive value, transparency and consistency both in terms of costs and in terms of innovation and service, and
- facilitate consolidation of those responsible for managing code change. This may happen organically where synergies exist between codes that can allow one code manager to win multiple tenders. Or it could take place by design where we choose to compete code management and, where relevant, system delivery responsibilities across multiple codes as part of the same tender.

3.10. Competitive tendering has been successful in other licensed regimes in the energy industry and has delivered significant consumer benefits. For example, the first three rounds of our Offshore Transmission Owner competitive regime has attracted £3.1 billion in investment value and is estimated to have saved £700 million for consumers.[30] Its success has recently led to competitive tendering also being introduced for onshore transmission assets. We note that some of the existing code administrators were appointed through a competitive process, establishing that there are no intrinsic barriers to introducing

[30] https://www.ofgem.gov.uk/news-blog/our-blog/ofgem-encourages-investment-uk-electricity-links

competition across the industry. We think there are opportunities to extend established procurement practice to the appointment of code managers and delivery bodies.

3.11. There may be some codes where the benefits of introducing competition may be less clear. In the context of the NGET administered codes, we have an existing regulatory relationship with the code administrator through its electricity transmission licence.[31] Therefore it may make sense to strengthen the licence conditions of NGET to introduce the new code management responsibilities instead of competitively appointing an alternative code manager. We consider that the argument for doing so is dependent on the extent of conflicts of interests and synergies between NGET's wider role in the market and the additional responsibilities that it would take on as a code manager for the CUSC, STC and Grid Code.

3.12. For the case of NGET, and more generally, we expect to include the relative benefits and any possible downsides of introducing competition for code management and system delivery roles within an impact assessment that we will conduct at a later stage of consultation. At this stage we are interested in your views on the relative pros and cons of strengthening NGET's licence conditions as opposed to introducing competition for the role.

Options for licensing

3.13. Based on existing precedent in the energy sector, there are two possible approaches to awarding licences for the new roles:

- **Permissive licences**: A low bar pre-requisite to bidding for the role, which allow an organisation to carry out a relevant role, potentially subject to meeting certain requirements.
- **Sole provider licences**: A single licence per code, requiring the licensee to provide the relevant service. This is awarded as a result of the competitive licence application process.

Permissive licences

3.14. Permissive licences would require applicants to pass a range of basic requirements, similar to the level of requirements placed on suppliers to obtain licences currently.[32] The successful applicants would then form a pool of code managers permitted to bid for the role of code management (and system delivery, where applicable) for a particular code.[33]

3.15. Permissive licences could be used as a low barrier to entry approach, to help to open competition in the area of code management to new parties – although there is a balance to be struck with ensuring that the minimum requirements are not too low. Detailed

[31] The licence requires NGET to have in place the CUSC, STC (together with other transmission licensees) and Grid Code and for the codes themselves to establish a code administrator, which is currently NGET in each case.
[32] The requirements set out in the CMA final report (paragraph 19.382) are a starting point; we expect to expand these.
[33] In many ways this approach would be similar to having a pre-qualification round (i.e. provision of permissive licences) and then a tender for the contract to take on responsibility for the code management role.

requirements and incentives could be set out in a services contract, which would be awarded following a successful tender process, or in special conditions in the licence that has already been granted. The contract or special conditions could also include the funding and budget arrangements.[34]

3.16. This approach could also ensure direct accountability for code management and system delivery to us, via the licence, for delivering in the interests of consumers. For example, the permissive licence could include a condition requiring compliance with the service contract (if one was put in place). It may create a ready pool of applicants that could compete to take on the role where new service functions are added to existing codes and when service contracts expire.[35]

3.17. In some cases, the two-stage process with functions and requirements potentially set out in different legal documents may be overly complex. It will be necessary to consider what contractual relationships are needed for service delivery and whether it is possible that new contractual vehicles linked to the codes will be needed. With permissive licences and service contracts, our influence over specific service requirements may be limited.

Sole provider licences

3.18. Sole provider licences would include the requirements, incentives and revenue entitlement within the conditions of the licence itself. Only the parties that will undertake the role would receive a licence. There are benefits to a competitive licence application process with a carefully thought-out balance between accountabilities to industry (via code panels) and consumers (via Ofgem).

3.19. This direct relationship between code managers, delivery bodies and Ofgem seems best to ensure delivery of the benefits that the CMA is seeking to deliver, but without the need for requirements to be contained in two separate legal documents (as with a service contract). However, this may be overly interventionist and burdensome for some codes, where a more direct relationship between the code manager and industry is justified.

Who runs the application process?

3.20. Within these two types of licences, we have the choice of whether it is us or another body that runs the competitive application process and selects the code manager who will also take on delivery body responsibilities. The current code panels are one possible alternative to us that could run the initial process.

3.21. Our running of the application process would provide us with greater control over its direction to satisfy ourselves that the successful bidder is able to deliver against its incentives and requirements. It implies a role for us in ensuring cost efficiency, perhaps including through competition on cost as part of the tender process.

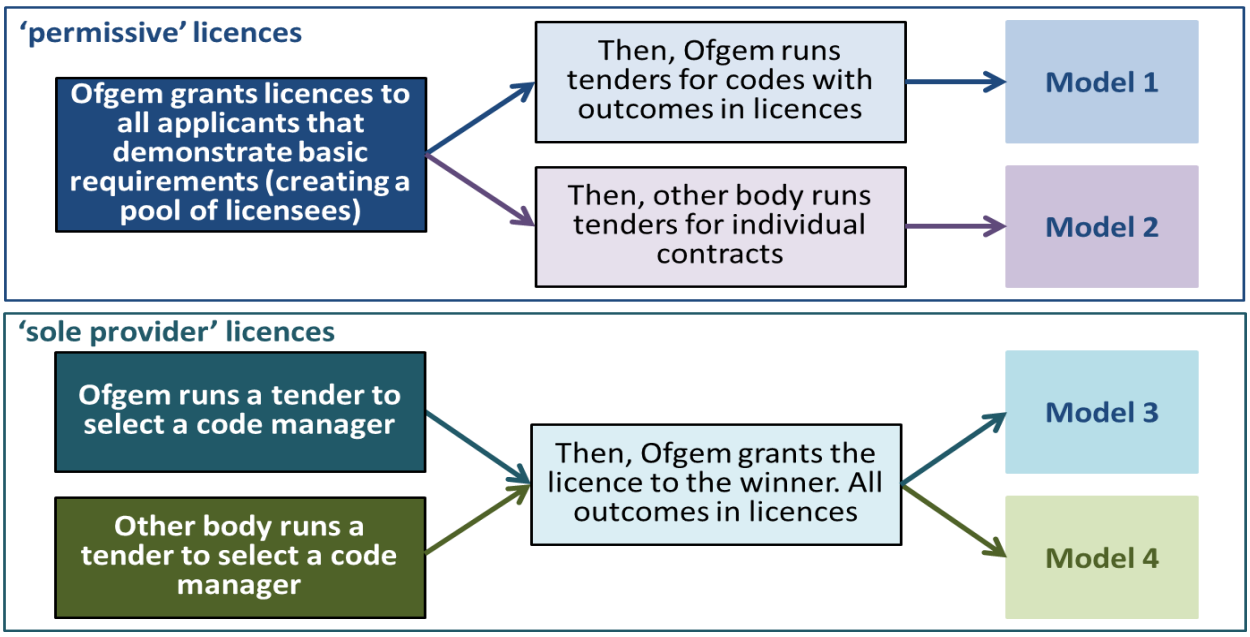
3.22. If another body were to run the process, significant Ofgem input would still be required throughout (eg we would need to have input into the design and implementation of

[34] An alternative could be for some of this information to be included in the codes themselves.
[35] While there would be a pool of possible applicants, there would still remain only one code manager responsible for the management of any one code at a time.

the competitive process). We may consider using such a model as a more proportionate approach where a code manager and/or delivery body role is more industry facing and where industry parties' interests are more clearly aligned with those of consumers. In addition, the scale of strategic change which we expect to see under the code may be an important consideration.

Four models for competition and licensing

3.23. Based on the discussion above, there are four potential models for competition and licensing.[36]



3.24. Table 2 summarises some of the 'pros and cons' of the four models.

3.25. We do not necessarily intend any of these four models to act as a 'one size fits all' for all of the codes within scope of the licensing regime. We recognise that Model 3 has advantages but that other models may be just as able to provide the benefits that we are seeking in a more proportionate way in some cases; for example smaller codes or those where the role is less likely to have a significant impact on the consumer. Therefore, it might be optimal to use a mixture of Model 3 and Model 2 (where the level of delegation to industry is proportionate) for different codes as appropriate. Model 4 provides an alternative to model 2. However it may require a more significant role for us in running the tender given that it will lead explicitly to granting of a licence. This may reduce the advantages that such an option could bring.

[36] The selection of the code manager may also require that body to take on system delivery responsibilities where applicable.

Table 2: Comparison of the four models for licensing and competition

	Ofgem runs competitive process	Alternative body runs competitive process
Permissive licences (pre-tender)	**Model 1** Pros: • Low barrier of entry approach. • Maintains a pool of applicants for future work. • Process could be designed and staggered to enable future code manager (and delivery body) consolidation. Cons: • More complex, two-stage approach to achieve the same outcome as model 3.	**Model 2** Pros: • Maintain high industry involvement. • Potentially more proportionate for smaller codes, with less direct consumer impacts. • Low barrier of entry approach. • Maintains a pool of applicants for future work. Cons: • Difficulty in deciding who is best placed to run tender and what vested interests may be. • Incentives and requirements on panels (if running tender) may mean that the consumer interest is secondary. • May still be a role for Ofgem on tender design and implementation (though likely to be less than Model 4). • Service contracts may be less transparent than licences.
Sole provider licences (post-tender)	**Model 3** Pros: • Appears closest to addressing CMA's concerns. • All requirements in the licences initially so less complexity (compared to two-stage approach). • Process could be designed and staggered to enable future code manager (and delivery body) consolidation. Cons: • May be disproportionate for smaller codes with less direct consumer impacts.	**Model 4** Pros: • Maintain high industry involvement. • Potentially more proportionate for smaller codes, with less direct consumer impacts. Cons: • Difficulty in deciding who is best placed to run tender and what vested interests may be. Incentives and requirements on panels (if running tender) may mean that the consumer interest is secondary. • Still requires a significant role for Ofgem on tender design and implementation (via the granting of a licence), so may not allow for level of delegation to industry which Model 2 would allow.

3.26. An additional consideration may be the breadth of the role. Where a system delivery function is associated with the code management role, then this may provide further justification for an Ofgem led licence application process as with Model 3 to ensure end-to-end delivery of change. It seems unlikely that Model 1 will deliver any additional benefits to Model 3, but it would be more complex to implement.

3.27. We appreciate that there are more questions to be answered in the development of our approach to licensing as we proceed to develop the CMA's recommendations. We intend to work up and engage with industry on the functions, outputs and incentives that we will place on new code managers and delivery bodies. These bodies will have an essential role to play in the new arrangements and the development of licence (or contractual) conditions depend on us developing and communicating a clear set of requirements for delivery.

3.28. Table 3 summarises some longer-term questions that we anticipate exploring going forwards.

Table 3: A summary of key areas of further work

	Key policy questions
Scope	• For NGET codes should we introduce new licences or strengthen existing licence responsibilities to reflect the new code manager responsibilities? • What functions and outputs should licensees be required to deliver?
Vision and key outcomes	• What does a successful code manager and delivery body licensing regime look like? • How many potential providers can we expect will be interested in code manager and delivery body roles? How can we ensure that the pool of potential providers is as wide as possible?
High level work programme and road map	• What will legislation to allow introduction of licences contain? • How will new code manager and delivery body roles be funded? • What will the competitive application process look like? How many stages will it involve and what will be the purpose of each stage?
Roles and responsibilities	• How should the code managers and delivery bodies interact with code panels and interested parties? • What requirements should be placed on industry parties to ensure that they facilitate progress of code change? • What impact will changes in the industry have on the scope and design of licences? For example, depending on the direction of the system operator under work considering its role, would this change our approach towards licensing of the codes that NGET currently administers?

4. Strategic Direction

Chapter Summary
This chapter outlines our initial views on an approach to developing a strategic direction for codes. Its sets out our views on the purpose of the strategic direction, some initial views what it could contain, and how it could be developed, implemented and maintained.

Question box

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?
Question 4: Which specific projects do you consider should be included in the initial strategic direction?

Introduction

4.1. The CMA recommends that Ofgem is responsible for the strategic development of codes. To do this the CMA recommends that we publish a cross-cutting strategic direction for codes to signal how it expects high-level policy changes will be implemented through changes to industry codes and other wider market changes.[37]

The purpose of a strategic direction

4.2. The electricity and gas industry is in a period of great change. Major, and in some cases complex, changes will be necessary to industry IT systems and to multiple industry codes to facilitate such change. The aim of the CMA's remedies is to ensure that regulation set in codes keeps pace with technical and commercial developments in the GB energy markets and promotes effective competition in a manner consistent with BEIS's and Ofgem's strategic objectives and policies.[38]

4.3. The strategic direction will be central to aligning code parties' objectives with Ofgem's focus on consumer interests. The strategic direction will set out, on an ongoing basis, what outcomes Ofgem is aiming to achieve through changes to industry codes, and as a result what the priority policy changes are. We will also use the strategic direction to provide the industry a steer regarding expectations for EU level and wider changes in the market.[39]

4.4. The strategic direction will be essential in setting the scope of the work carried out by the consultative board, and will be an important factor in determining the tasks and responsibilities of parties in the new regulatory regime.

[37] Paras 19.342-19.345 of the CMA Final Report.
[38] Para 19.297 of the CMA Final Report.
[39] Para 19.342 of the CMA Final Report.

Content of the initial strategic direction

4.5. A strategic direction could contain the following, to help use resources efficiently and let code modifications be prioritised effectively:

- key outcomes which we are aiming to deliver through the code changes
- a 'vision' of cross-code reform and an explanation of the key drivers
- an explanation of which projects are strategic priorities for Ofgem and BEIS
- an outline of the roles, responsibilities and accountabilities of stakeholders for delivering the strategic direction.

4.6. There are many code modifications in progress that are introducing changes to industry systems and processes. A number of these are the result of initiatives by government and Ofgem. Table 4 provides examples of projects in our 2016/17 forward work plan, which may result in changes to industry codes. These projects provide a starting point for the content of the strategic direction.

Table 4: Key activities and projects in Ofgem's 2016/17 forward work plan which may involve changes to industry codes[40]

	Key outputs			
	Regulation of Monopolies and Enabling Markets	**Effective Competition**	**High Standards of Outputs and Protection**	**Partnership with the Government & Stakeholders**
Key activities	Xoserve governance review	Half-hourly settlement	Smart meter rollout	Smart grids
	Major onshore investments	Flexibility strategy	Project Nexus	Future of gas
		System Operator role and structure		EU regulation and network codes
		Code governance review 3		
		Embedded benefits		
		Future retail regulation		
		Switching programme		
		CMA remedies		
		Micro business regulation		

Developing and implementing a strategic direction

4.7. There are three stages to developing a strategic direction;

- developing what it should contain and the level of detail required
- defining which stakeholders (including Ofgem) are responsible for which activities to deliver strategic change and developing a process to ensure it remains relevant (including the role of the consultative board)
- designing how stakeholders are made accountable for delivering in line with the strategic direction and incentivised to drive strategic change.

4.8. We will set out in a strategic direction, at a high level, what we intend to achieve through our projects and the associated milestones required to deliver them. We will update

[40] More information on the projects listed in this table can be found here: https://www.ofgem.gov.uk/system/files/docs/2016/03/forward_work_programme_2016-17.pdf

this periodically as projects progress to ensure it remains up to date and useful to stakeholders. It will be the role of industry, through mechanisms such as the consultative board, to develop and maintain a detailed joint industry plan to explain how the changes required to codes (for Ofgem's priority projects) can be delivered.[41] Therefore it will be important to consider how much detail is necessary in the strategic direction to provide a helpful steer to industry.

4.9. All stakeholders will have a role in delivering industry change in line with the strategic direction. This is essential to ensure that we are all working towards the same goal. For instance:

- Code managers and delivery bodies will need to work with the consultative board to develop a joint industry plan to deliver the strategic direction and prioritise their code modifications accordingly to ensure the timely delivery of strategic code changes.
- Code panels will need to understand and challenge how code modifications being proposed are aligned with the strategic direction.
- Code parties raising code modifications will need to highlight to code managers the modifications they consider to be linked to the priorities set out in the strategic direction.

4.10. It is therefore important that we consider how we incentivise the delivery of the strategic direction throughout the whole package of the reforms. We envisage that, if successful, strategically important modifications will be raised by industry rather than Ofgem and as a result we expect the 'call-in powers' will be rarely used.[42]

4.11. To bring this into effect we will publish a draft strategic direction in autumn 2017. This initial draft will be introduced on a voluntary basis and not be supported by any requirements in licences. Initially we will review the strategic direction after a year and make any necessary amendments in light of the work carried out by the consultative board on the joint industry plan.

4.12. We want to ensure that the strategic direction is capable of providing stakeholders with a meaningful steer. The current work to coordinate the individual code forward work plans, and (once operational) the consultative board's work on the joint industry plan will be important inputs into the development of a robust and realistic high level road map of reforms to codes.[43] This work is being developed in parallel to the strategic direction. Introducing the strategic direction in draft form for the first year will allow learnings from this work and how it works in practice to be reflected in the first strategic direction. It will also allow us to consider whether any changes to licence requirements or industry codes are necessary to deliver the strategic direction alongside our development of the licences for code managers and delivery bodies.

4.13. We recognise there are many areas which require further consideration before a strategic direction can be introduced; such as identifying exactly what roles and responsibilities each code party is required to deliver and understanding what tools we can

[41] More detail on the role of the consultative board is in the next chapter.
[42] This would provide Ofgem with the ability to intervene to 'call in' an ongoing strategically important modification proposal in the event of the occurrence of certain exceptional circumstances.
[43] Para 5.16 of the Code Governance Review (Phase 3): Final Proposals.

use to bring it into effect. Table 5 outlines the key policy questions we will consider in future to develop a strategic direction.

Table 5: A summary of key areas of further work

	Key policy questions
Scope	• Which aspects should the strategic direction provide clarity on and how much detail should it contain? Are prioritisation principles a useful tool?
Vision and key outcomes	• What does successful cross code reform look like? What are we trying to achieve and what are the key outcomes we expect?
High level work programme and road map	• What are the key work programmes on the horizon for the next 3-5 years, at a high level what are the impacts on codes and what are the interdependencies? • Which of the projects are high priorities for Ofgem (taking into account the high-level policy aims of BEIS)? • Based on the volume of changes expected to codes is it achievable? • What role do impact assessments have in determining the strategic priorities?
Roles and responsibilities	• What role should Ofgem play in the strategic direction compared to code managers, delivery bodies, code panels, code parties and the consultative board?
Implementation	• What mechanisms (eg code modifications, licence modifications, or voluntary agreements) should be used to ensure the strategic direction is implemented and followed? • Would the mechanisms differ once the full the package of reforms are in place?

Next steps

4.14. To achieve this we intend to work with stakeholders to develop a draft of the strategic direction by late 2017. Once the consultative board is operational next year we will work with it to develop the joint industry plan required to deliver the strategic direction.

4.15. In the near term, we would like to hear your views on the questions outlined at the start of this chapter and any other comments you have on our approach to developing a strategic direction.

5. Consultative board

Chapter Summary
This chapter focuses on the CMA's recommendation that Ofgem set up and run a standing forum (the 'consultative board') to bring stakeholders together to discuss and address cross cutting code issues. It outlines why we need a consultative board and proposes a role for it. This includes functions recommended at the outset, with others added over time to reflect a re-orientation from an operational to a strategic body.

Question box

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

Background

5.1. The CMA recommended we set up and run a consultative board to bring stakeholders together to discuss and address cross-code issues. It gave the board a wide remit,[44] but intended it to be a body that would coordinate cross-code changes linked to the development and delivery of Ofgem's strategic direction.

Coordination of cross code change

5.2. The issue we need to resolve is the pace of delivery of cross-code changes that benefit consumers. This needs to be faster. Incentives for change play a key role in this. In some cases, there is a lack of incentives under the current system for industry to engage in the change process. For example, where changes have substantial financial costs that are distributed unequally between players, or where changes are likely to have different commercial impacts because of customer base. The current system is not set up to facilitate delivery of change that benefits consumers. The structure needs to change to support better coordination of change across codes, with code managers and delivery bodies accountable not only to their shareholders but also to the wider public interest.

5.3. At present, code parties and Ofgem (in restricted circumstances) can raise a code modification proposal, in accordance with the provisions under the applicable licence and industry code.[45] Government policy can also necessitate code changes. If cross-code or consequential impacts from a code change are identified, the pace of development is dictated by the subsequent code, not the code where the change originated. This can slow down the delivery of change.

Our proposed role and remit for the consultative board

5.4. Having developed a strategic direction for code development, we see industry leading the delivery of change, with Ofgem playing a facilitative role.

[44] Paras 19.349 and 19.399 of the CMA final report.
[45] Additional persons or bodies are able to raise modifications under the provisions of the code.

5.5. We therefore see the board's key purpose as coordinating and facilitating delivery of strategic changes across codes. The board provides an opportunity to deliver changes that benefit consumers faster through better management and sequencing of change. We see its focus being operational at first, centred on enabling delivery of the strategic direction by translating this into a joint industry plan, using the forward work plans of each code body as its basis. The board would sequence strategic changes, with each code manager and delivery body raising and delivering the required modifications in accordance with the plan. The board would consider volume of change and dependencies in developing the joint industry plan. This is likely to be iterative.

5.6. The board would monitor delivery of the joint industry plan, identifying and removing obstacles. This would fill the gap identified in the joint planning and operation of cross cutting code modifications. The board will help ensure the strategic direction is realistic, and capable of providing the required steer for industry. It would make sure delivery timetables, sequencing of change and cost efficiency are sensible.

5.7. Over time, we see the role of the board being re-set to more of a strategic body with additional functions, such as considering the scope of codes. This is because we see the board taking a more proactive role in tackling long-term system level issues. We will review the board, perhaps either once a milestone has been achieved, such as the production of the joint industry plan with clear evidence of ongoing delivery of cross-code change, or after a specific time period has elapsed. The review could assess what is working and what areas may need strengthening, and it may be the right time to review also the board's remit and composition.

5.8. The board complements the suite of reforms we are putting in place. For it to play a legitimate role within the code governance landscape, it will need to both fit with current arrangements and work with enduring arrangements, particularly once we introduce licensing of code managers and delivery bodies.

Powers

5.9. The board will act in an advisory capacity. Members will work collectively to deliver their respective activities in support of the strategic direction. However, we believe the board should be capable of making non-binding recommendations to us on strategic code development. The scope of recommendations could include, for example, concerns and issues identified in its discussions on the development and delivery of the strategic direction. Market participants, code panels, code managers and delivery bodies should have an obligation to provide information to the board to develop and monitor the joint industry plan.

Functions proposed for the board

5.10. Table 6 lists the functions proposed for the board at the outset.

5.11. Once delivery of the initial joint industry plan has reached a steady state, the plan will need to be monitored and updated on an ongoing basis, in line with refreshes of the strategic direction. While there will be an enduring need for the board to perform this function (perhaps in time through a working group), reaching this position would allow the board to become more of a strategic body with a revised set of functions that capitalise on its expertise over the longer term. For example, the board could step back and consider tackling other long-term system-level issues, such as the scope and consolidation of codes.

It would also be in keeping for the board to identify key policy, regulatory and technological developments and suggest how these might be relevant to its work or strategic code development. This may require the board to have additional resource depending on the approach it takes. For example, it could commission analysis from individual code managers, and/ or seek input from market participants. In a strategic role, the board might also advise Ofgem on the need for use of call-in powers to deliver the strategic direction should delays or obstacles occur.

Table 6: List of functions proposed for the board at the outset

Role	What this could mean
Cross code change/ Strategic Direction	
Inform the content of the strategic direction and assist Ofgem with the coordination of cross-code changes, including the strategic direction	▪ Contribute to initial strategic direction and its regular refreshes through formal and informal consultations ▪ Own a modifications register as a single point of reference for all cross-code change proposals ▪ Where appropriate, review the legal text for a cross-code change to ensure consistency between codes
Develop and maintain a joint industry cross code change plan to facilitate delivery of the strategic direction and ensure consistency across codes	▪ From the forward work plans produced by each code body, develop and maintain a joint industry plan in line with the strategic direction ▪ Manage delivery of the joint industry plan: review delivery progress regularly; help remove obstacles and delays to implementation of cross-code changes; make recommendations for code changes to individual code panels
Perform an assurance role for delivery of the strategic direction/ joint industry plan	▪ Provide informal assurance of strategic direction/ joint industry plan. For example by: providing independent oversight of likely future performance; identifying critical success factors and barriers to success; confirming right approach has been adopted and plans are complete and accurate
Code Governance System	
Provide a mechanism to improve Ofgem's understanding of the substantive scope of the code regime[46]	▪ Development of a joint industry plan will help Ofgem take better account of industry's capacity to deliver strategic change, particularly when a number of initiatives are happening simultaneously
Perform a risk management/ risk mitigation role	▪ Identify, assess, and prioritise risks ▪ Coordinate resources to reduce likelihood and impact of risks
Make non-binding recommendations to Ofgem on strategic code development, which we can decide whether to accept	▪ The scope of recommendations could include, for example, concerns and issues identified in its discussions on the coordination of cross code change
Stakeholder engagement	
Facilitate engagement between the industry, Ofgem, code panels, code parties, code managers and delivery bodies	▪ Provide a space for informal engagement
Share best practice, learning and experience	▪ Communicate 'best in class' examples of delivering cross code change ▪ Raise awareness of the pitfalls and common problems in achieving cross code change with a view to overcoming these ▪ Look at how other sectors deliver coordinated code changes and consider whether they are helpful for the board's purposes

[46] Currently, Ofgem interacts with the codes only in a limited number of contexts, such as when undertaking an SCR or deciding whether to approve a material code change that has been developed by the industry. Typically our role requires us to analyse the code change in question in isolation, rather than as part of a package of related code changes or in relation to any sort of strategic work plan.

5.12. We see change proposals considered through the self-governance procedure and the power to make formal decisions that are binding on Ofgem, as out of scope for the board.

Next steps

5.13. After we have considered responses on the role and remit of the board, we will run follow up stakeholder workshops next spring on the board's composition, terms of reference, funding and appointments process. We want to have the board up and running in early 2018 following the publication of a draft strategic direction.

5.14. Table 7 shows the key policy questions not part of this consultation that we will need to consider in time. We will take forward these questions in the next stages of work, such as when we develop terms of reference and composition of the board.

Table 7: Key policy questions that will we need to consider at a future stage

	Key policy questions
Vision and key outcomes	• How do we ensure faster delivery of benefits to consumers and competition through the board? • What are the board's critical success factors?
Roles and responsibilities	• How should the board be composed to enable it to fulfil its role? • How can the board best work in partnership with code managers/delivery bodies/ code panels/market participants? • At what point might the board reset from an operational to a strategic body?
Implementation	• What mechanisms should be used to ensure the joint industry plan is followed?

6. Moving to new arrangements

Chapter Summary
This chapter sets out our thoughts on how we minimise the effect of moving to the proposed new arrangements.

Question box

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?

Impact on existing and upcoming projects

6.1. The remedies recommended by the CMA and our Code Governance Review (Phase 3) (CGR3)[47] changes build on reforms that we have already introduced. They seek to improve code governance so that codes can develop within the broader regulatory framework.

6.2. In particular, all these developments aim to better support large scale and complex change to the gas and electricity industry in Great Britain. This includes the:

- Roll out of gas and electricity smart meters to 53 million domestic and non-domestic premises by 2020.
- Low carbon transition, which will lead to more intermittent electricity generation and new low carbon technologies, with potentially a greater role for flexibility in the system including demand side response (DSR).
- EU Third Energy Package, which has introduced and is introducing new legislation, known as European Network Codes (ENCs), governing the design, operation and planning of the European energy sector.

6.3. These changes are already driving reform to the detailed rules that underpin the industry; further reforms are needed. In some cases work has started, and modification proposals to a number of industry codes are being discussed.

6.4. In November 2015, Ofgem launched the Switching Significant Code Review (SCR). The objective of the Switching Programme, and the Switching SCR, is to improve customers' experience of switching, leading them to engage more in the retail energy market with a new switching process that is reliable, fast and cost-effective. In turn this should build consumer confidence and facilitate competition, delivering better outcomes for consumers. Although we have a central team leading the programme, suppliers, networks and the Data

[47] https://www.ofgem.gov.uk/publications-and-updates/code-governance-review-phase-3-final-proposals

and Communications Company (DCC) will all have to establish change programmes to update their own systems. This will allow them to interface with the new industry arrangements and systems being developed by the Ofgem-led Switching Programme.

6.5. In June 2016, we announced our decision to launch an SCR to progress mandatory half-hourly settlement reform, but only once the work involved has been thoroughly planned and scoped. We will consult on the plan for settlement reform later this year. This is a major undertaking that will involve significant changes for suppliers, supplier agents and others, as well as substantial changes to central systems, which emphasises the need for robust and transparent planning.

6.6. The proposed reforms in this document are unlikely to affect the governance of these programmes of work directly, and therefore they should continue under their current governance processes to ensure that they are implemented, and the benefits realised, as early as possible. We would note that, once in place, the consultative board is likely to be able to support and input into these projects. When the other changes discussed in this document are implemented, they should help ensure these types of programmes of work achieve their aims in a more timely and effective way. For example, these projects are likely to be included in the strategic direction, when in place.

6.7. We also recognise that other work programmes may begin in the intervening period before the changes in this document are fully implemented. We believe these programmes should not be delayed by waiting for these changes to be introduced. However, it will be important to keep in mind interactions between any additional programmes of work and the implementation of the changes set out here. We will need to ensure that the changes to code governance do not create any uncertainty surrounding such work programmes.

Call-in powers and future of the SCR process

6.8. CGR3 provided for three options that could be followed under an SCR process: one is to retain the ability to follow the existing SCR process, under which we direct a licensee(s) to raise modifications at the end of the SCR. In addition, we introduced the ability for us to raise a modification proposal(s) at the end of the SCR, and the option to let us lead an end-to-end process to develop code modification(s). The SCR options now available should let us deliver complex cross-code changes before the CMA's reforms are implemented.

6.9. One of the CMA's proposed remedies is for us to take powers to initiate and prioritise strategically important modification proposals. Another is the creation of a backstop 'call-in' power for Ofgem, which would enable us to take control of strategically important modification proposals in certain exceptional circumstances.

6.10. The CMA considered that together these two remedies would form an effective substitute for our SCR powers and we agree.

6.11. We also think that the enhanced role of the code managers and delivery bodies will further ensure that strategically important modification proposals are delivered efficiently and promptly. But to ensure this enhanced role is effective, the licensing regime of code managers and delivery bodies should be in place. Therefore, we do not expect to remove the SCR process before the licensing arrangements are in place.

6.12. Our SCR powers are unlikely to be required once the full package of remedies is in place, but we will continue to use the SCR process in the interim. In particular, we will continue to follow the SCR process for the Switching SCR and the mandatory half-hourly

settlement SCR, although noting the draft legislation to give Ofgem enhanced powers to expedite switching and settlement reform, which the Energy and Climate Change Select Committee has recently considered.[48] If these new powers were provided, we would expect to stop the SCRs and use these powers for the remainder of the process for both settlement and switching.

Approach to implementing the new licences

6.13. As we look to introduce licences, and transition from code administrators to the expanded role of code managers, we must consider how best to move from the current to the future arrangements.

Staggered competitive applications

6.14. There may be a number of issues that arise if we were to seek to run competitive applications for all the new roles simultaneously. These processes tend to be resource heavy, for both the party running the application process and any applicants. It is important to ensure that, whichever model(s) of licensing and competition we choose to implement, we do not create a disproportionate resource burden if we can reasonably allocate the resource requirement for the application process over a longer period.

6.15. Potential bidders may have limited resources for preparing the applications, and so may be unable to bid for as many opportunities as they might if the competitive applications are staggered over several years.

6.16. Alternatively, the design of the application process may lend itself to be run simultaneously for all roles. Further, staggering competitive applications will delay realising the benefits of competition and licensing for all but the first round.

6.17. We would need to consider carefully the appropriate timeline for competitive applications. Some of the key considerations are:

- *How many licences or contracts to run applications for each year?* As a main reason to stagger is to avoid overwhelming us or potential bidders, we will consider carefully what might be a reasonable number of applications to take place at once. Elsewhere[49] we often see two to four a year.
- *How frequently to re-compete each position?* Current code administrator contracts are generally around three to six years. The length of licence or contract might differ by code and we expect to consider each case-by-case. The terms need to be long enough to attract bidders, but also to allow time for applicants to implement the new aspects of the expanded code manager role, but not so long as to deter competition from alternative service providers.

[48] http://www.parliament.uk/business/committees/committees-a-z/commons-select/energy-and-climate-change-committee/inquiries/parliament-2015/pre-legislative-energy-15-16/

[49] For example, OFTO tendering has about four per round (rounds are not necessarily one year long), and the DfT has deliberately staggered the passenger rail franchise timeline to have two to three applications each year.

- *In which order to compete the licences or contracts – including which to compete at the same time.* If we do decide to stagger the applications process, careful consideration will need to be given to how this is done. In particular, whether there would be benefits to tendering for licences or contracts at the same time where there are correlations between the associated codes, and therefore potential advantages in terms of potential future code manager and delivery body consolidation. Or whether such advantages could be realised by tendering for such associated licences or contracts at varying times. Further, we need to recognise industry change and any effect that the licensing regime could have on delivering it.

Code governance prior to implementation of the licensing regime

6.18. It is vital that the code governance regime in the period until the licensing regime is put in place, enables, as best it can, the consideration of the long-term development of codes within the broader regulatory framework.

6.19. Importantly, the implementation of our CGR3 proposals including the newly introduced performance metrics and survey should make incremental improvements prior to the implementation of the new regime: indeed we believe these changes will help code administrators and the wider industry prepare for the more fundamental changes proposed by the CMA. These together with the development of a strategic direction by us and the introduction of the consultative board should bring forward some of the benefits of the CMA's remedies prior to the implementation of the licensing regime.

6.20. However, as we develop the new requirements, outputs and incentives for the new roles, we will consider whether there would be benefits in implementing these via a voluntary regime before a licensing regime is introduced. In particular, we will consider whether such a regime would enable a smoother transition to a licensing regime.

Appendices

Index

Appendix 1. Consultation Response and Questions

A1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

A1.2. We would especially welcome responses to the specific questions set out at the beginning of each chapter heading and which are replicated below.

A1.3. Please respond by 1 February 2017 and send responses to:

Laura Nell
Code Governance Remedies
Ofgem, 9 Millbank, London SW1P 3GE
0207 901 7000
CodeGovRemedies@ofgem.gov.uk

A1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

A1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if you could submit responses both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

A1.6. Next steps: Having considered the responses to this consultation, Ofgem intends to consult further before finalising our approach. Send any questions to:

Laura Nell
Code Governance Remedies
Ofgem, 9 Millbank, London SW1P 3GE
0207 901 7000
CodeGovRemedies@ofgem.gov.uk

CHAPTER: Two: Scope of the new arrangements

Question 1: Do you agree that the codes and functions we have identified (ie. 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?

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?

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?

Question 4: Which specific projects do you consider should be included in the initial strategic direction?

CHAPTER: Five: Consultative board

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

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?

Appendix 2. Summary of CMA remedies for industry code governance

A2.1. In the CMA's Final Report, it found that a combination of features of the wholesale and retail gas and electricity markets in GB relating to industry code governance give rise to the Codes AEC. It considered that this AEC limits innovation and causes the energy markets to fail to keep pace with regulatory developments and other policy objectives.

A2.2. To remedy the AEC, the CMA made the following recommendations to Ofgem:

- to publish a cross-cutting strategic direction for code development;
- to oversee the annual development of code-specific work plans for the purpose of ensuring the delivery of the strategic direction;
- to establish and administer a consultative board in order to bring stakeholders together for the purpose of discussing and addressing cross-cutting issues;
- to take powers to initiate and prioritise modification proposals that, in its view, are necessary for the delivery of the strategic direction;
- in exceptional circumstances, to intervene to take substantive and procedural control of an ongoing strategically important modification proposal; and
- to modify licence conditions to grant each code administrator the power to initiate and prioritise modification proposals that, in its view, are necessary for the delivery of the strategic direction or to improve the efficiency of the governance arrangements.

A2.3. It also recommended that the DECC (now BEIS):

- should enact legislation to grant Ofgem the power to modify codes in certain exceptional circumstances; and
- should require a licence for the provision of code administration (and delivery) services and, in the process of designing the associated licence conditions, ensure that such licence conditions are appropriately targeted to incentivise code administrators to take on the expanded role envisaged under this remedies package and minimise the regulatory burden on those entities.

A2.4. The CMA set out that it had designed its remedies to balance the powers and responsibilities allocated to the relevant stakeholders efficiently, taking into account the resources and expertise of each stakeholder group, as well as their independence from commercial interests (ie the ability to act in the interests of consumers). It had also considered the relative importance of each modification proposal and the need to prioritise scarce resources (eg to focus Ofgem's attention on material modification proposals).

A2.5. The CMA recommends that Ofgem is responsible for the strategic development of codes. To do this the CMA request that Ofgem publish a cross-cutting strategic direction for codes.[50] The aim of this remedy is to ensure that code modification proposals are considered holistically and efficiently prioritised by stakeholders to support the BEIS and Ofgem's strategic objectives.

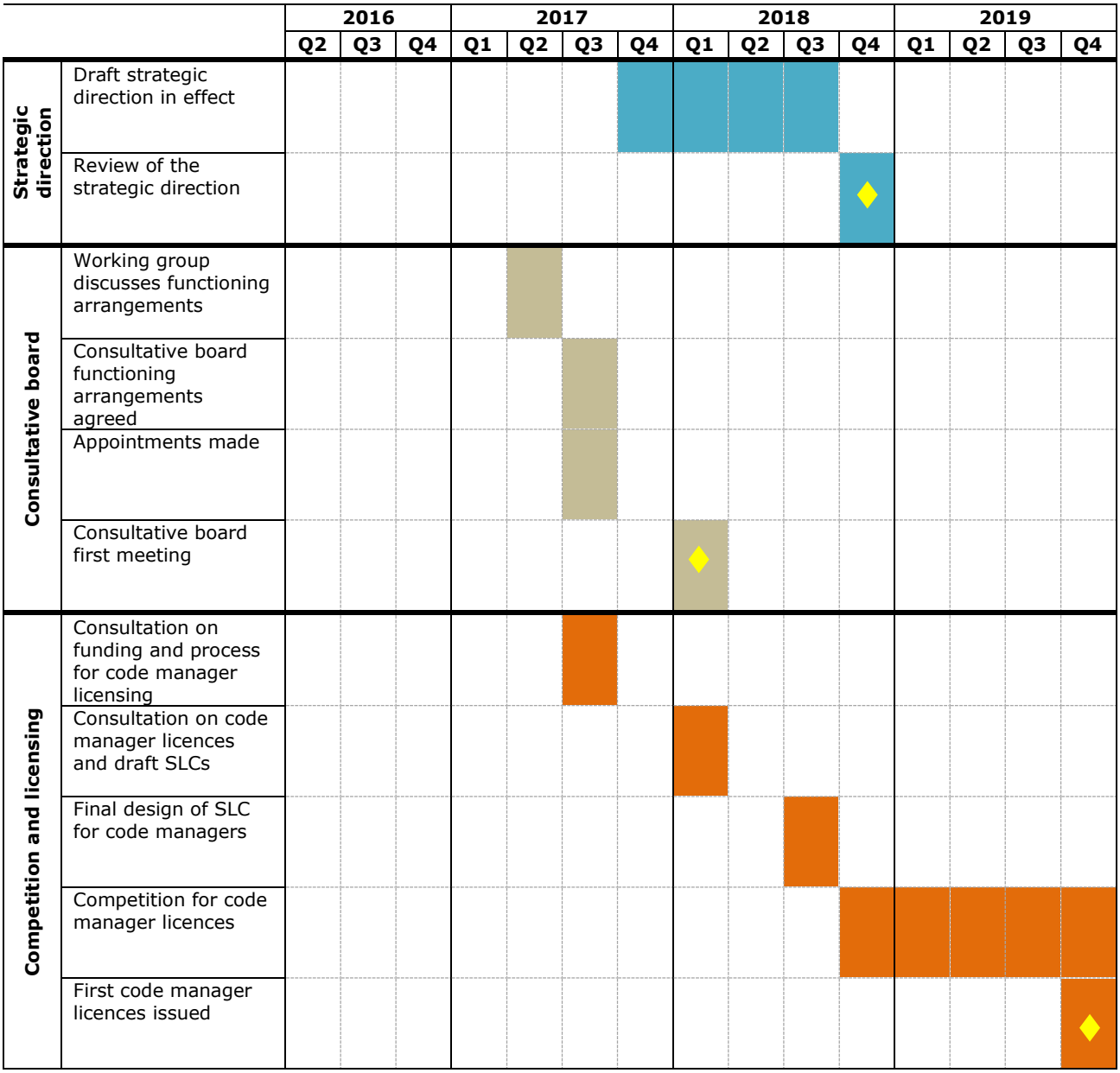
A2.6. The CMA recommends that the strategic direction includes:

- an explanation of how high level policy changes will be implemented via code changes;
- a description of Ofgem's understanding of the volume, nature and proximity of all relevant future changes (including its expectations for EU level and other wider market changes), and;
- a framework for code managers to exercise of their powers to initiate and prioritise modification proposals.[51]

A2.7. In the CMA's final report, it also recommends that Ofgem develop and publish the strategic direction alongside Ofgem's annual forward work plan.

[50] Paras 19.342-19.345 of the CMA Final Report.
[51] Ibid

Appendix 3. Timeline



Appendix 4. Glossary

AEC: Adverse Effect on Competition. Prevention, restriction or distortion of competition.

BEIS: Department for Business, Energy and Industrial Strategy.

BSC: Balancing and Settlement Code. It contains the rules and governance arrangements for the electricity balancing mechanism and imbalanced settlement process.

CACoP: Code Administration Code of Practice. It puts forward principles for Code Administrators to follow, but also sets out principles applicable to a Code Modification process.

Call-in power: The ability to intervene to 'call in' an ongoing strategically important modification proposal in the event of the occurrence of certain exceptional circumstances.

CGR3: Code Governance Review (Phase 3). The latest phase of the Ofgem project sought to improve the governance arrangements of these codes and reduce fragmentation.

CMA: Competition and Markets Authority. The competition authority for the UK.

Code administrators: The organisations that are currently contracted, or otherwise held responsible, for providing administration services to facilitate progression of code change by relevant industry parties.

Code managers: A term used to reflect the new roles and responsibilities that will be assigned to a new set of licensed organisations under future arrangements. These organisations will continue to play a role in 'administrating' codes but will also take on new responsibilities for ensuring progression of code change under the licences that we will introduce.

Code Parties: A collective term for all market participants and any organisation engaged, or wishing to engage, in the activities covered by the industry codes. In respect of the Grid Code and the Distribution Code the definition used is Code Users which we encompass within our Code Parties definition from this point onwards.

CUSC: Connection and Use of System Code. It and sets out the contractual framework for connecting to and using the NETS.

DC: Distribution Code. It covers the technical aspects relating to the connection and use of the electricity distribution licensees' distribution networks.

DCC: Data and Communications Company. It is responsible for linking smart meters in homes and small businesses with the systems of energy suppliers, network operators and energy service companies.

DCUSA: Distribution Connection and Use of System Agreement. It is a single centralised document relating to the connection to and use of the electricity distribution networks.

DECC: Department of Energy & Climate Change. DECC became part of the Department for Business, Energy & Industrial Strategy in July 2016.

Delivery bodies: Those organisations responsible for running the central systems and processes that underpin the codes. They are also responsible for implementing changes to systems (often but not necessarily IT systems) in order to give effect to code modifications once approved.

DSR: Demand Side Response. A broad term that refers to a range of mechanisms designed to reduce peak demands on the electricity system, potentially delivering a number of benefits including reduced cost of electricity supply and improved efficiency of investment in transmission and distribution networks.

DTS: Data Transfer Service. It provides a managed file transfer service that allows participants in the electricity sector to share data safely and efficiently.

ENCs: European Network Codes. Legislation governing the design, operation and planning of the European energy sector.

GC: Grid Code. It contains all material technical aspects of connections to, operation of, and use of the NETS.

HHS: half-hourly settlement. As part of the settlement process, the arrangements for using actual half-hour meter readings to determine how much a supplier's consumers use in each settlement period.

iGT: independent Gas Transporter. It develops, operates and maintains local gas transportation networks.

iGTUNC: independent Gas Transporters Uniform Network Code. It streamlines and harmonises the network code arrangements of the iGTs.

ISO: Independent System Operator. In the UK context a transmission system operator is independent from the Government and the National Grid.

MRA: Master Registration Agreement. It provides a governance mechanism to manage the processes established between electricity suppliers and distribution companies to enable electricity suppliers to transfer customers.

NETS: National electricity transmission system. The high voltage transmission network.

NETSO: National Electricity Transmission System Operator. Operates of the high-voltage transmission system.

NGET: National Grid Electricity Transmission Plc.

Ofgem: Office of Gas and Electricity Markets. The UK regulator for both gas and electricity.

SCR: significant code review. A process which provides a tool for Ofgem to initiate wide ranging and holistic change and to implement reform to a code based issue.

SEC: Smart Energy Code. It sets out the terms for the provision of the Data Communication Company's (DCC) services and specifies other provisions to govern the end-to-end management of smart metering in gas and electricity.

SPAA: Supply Point Administration Agreement. It sets out the inter-operational arrangements between gas suppliers and transporters in the UK retail market.

SQSS: System, Security and Quality of Supply Standards. It is a set of minimum technical standards that TOs and the SO must adhere to when planning and operating transmission systems.

STC: System Operator – Transmission Owner Code. It sets the roles and responsibilities of the NETSO and each Transmission Owner (TO) with regard to the planning and operation of the NETS.

TO: Transmission Owner. It owns and maintains transmission facilities.

TRAS: Theft Risk Assessment Service. It is a data analytics service for GB energy Suppliers to assess the risk of energy theft at consumer premises to help target theft investigations.

UNC: Uniform Network Code. It is the hub around which the competitive gas industry revolves, comprising a legal and contractual framework to supply and transport gas.

Appendix 5. Feedback Questionnaire

A5.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

A5.2. Please send your comments to:

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