Ofgem Consultation on industry code governance:

Comments by the CUSC Panel Chair

This note responds to the ofgem consultation on the implementation of the CMA's findings on code governance. It reflects the views of the independent chair of the CUSC panel and is not the formal view of the panel as a whole, although the views of panel members have been taken into account. It is not intended to be exhaustive: it's purpose is to identify some points which ofgem may find it useful to bear in mind in developing its proposals further.

Strategic direction

A statement by ofgem of its strategic direction and purpose in the development of codes would be a significant contribution to good outcomes. It will be important for this statement to be couched in terms which are sufficiently focussed and specific for panels and code managers to understand clearly what is expected of them. They also need clear direction on the urgency of change. Ambiguity as to direction or speed would significantly detract from the value of the statement.

The Consultative Board

The case for trialling such a board is strong, as cross code co-ordination has not always been effective to date.

It is not clear in the consultation document whether the board would have the authority to override decisions taken by panels or code managers as to priorities in the management of mods.

This may not be a trivial issue. To date panels have been very cautious about prioritising some mods over others and have preferred to take a first come, first served approach to avoid consigning less pressing mods to protracted timescales. Pushing mods to the back of the queue may be controversial and the situation will not be helped if there is uncertainty as to which body makes the final call on ordering of mods.

Code management

The ofgem consultation discusses options for the tendering of code manager licences, but is not clear on the nature of the service which is to be tendered.

The following issues need to be clarified before a sound decision can be made on how the managers are to be selected. These include:

1. **The roles of ofgem and the panels in the appointment of code managers**

It appears to be implicit in ofgem's proposals that ofgem will have the prime responsibility for the process of selecting the licensed manager, for the decision on the selection of the manager, and for monitoring the manager's performance. However in practice the manager will be providing a service to the code panel rather than to ofgem and for this reason the panels themselves should have a major role in the appointment and supervision of the manager. This point needs to be clarified.

2. **Scope of the manager's responsibilities**

Ofgem needs to define the scope and limitations of the manager's responsibilities. If the role is seen to be fairly similar to the current administrators (i.e essentially process management and administration) the skills may be generic and there will be a large population of potential managers. One manager with general high level knowledge of the industry and detailed knowledge of code change processes may be qualified to manage a number of codes. If, on the other hand, as implied in the consultation documents, the licensed managers are expected to drive and manage major changes to their codes, they will need specific expertise in the areas covered by the code in question. For example, a manager who is expected to initiate and manage a significant code review for the charging sections of the CUSC will need expertise in welfare and energy economics as well as reasonable technical knowledge of how the energy market and the grid function. The manager for the grid code may need more electrical engineering expertise, but less high level economics. In both cases it should not be enough to argue that the panel and consultants can provide the expertise, as commissioning and managing studies requires a good client side understanding of the issues.

As a number of code changes raise legal issues, ofgem also needs to be clear on whether the code manager is empowered or required to provide that advice to panels, either internally or by commissioning independent lawyers.

3. Funding levels and structures

There is a long history of performance failures resulting from poor funding arrangements in the public sector, and the CUSC panel has experienced difficulties arising from uncertainty as to the responsibility for payment of consultants. Before settling on an approach to tendering, ofgem needs to be clear on the level and structure of payment to the code manager. Clearly this cannot be determined until the scope of the manager's role has been defined.

The signals are that ofgem understands that cost minimisation is not the biggest priority in code management. The amount of money at stake in the effective functioning of the market far outweighs the cost of code management.

Whatever overall amount of remuneration is allowed, the design of the funding mechanism needs to be carefully structured to avoid perverse incentive effects. On the one hand, a fixed price contract would encourage thrifting of work and the avoidance of, say, use of technical consultants even where they are needed. Linking remuneration to hard performance incentives would not incentivise good performance or penalise bad management resulting from cost thrifting. Much of this lies in soft judgements on how well the manager gets the panel home on difficult issues. On the other hand a cost plus contract would invite inefficiency and gold plating.

MRT

31 January 2017.