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1 February 2017

Dear Laura

RE: Initial consultation on implementing the Competition and Markets Authority's (CMA) recommendations

We welcome the opportunity to respond to this important consultation on code governance as it starts to flesh out how the CMA's recommendations will be implemented by Ofgem.

The consultation proposes the introduction of new licensing arrangements for code managers and delivery services for only some of the commercial and technical codes. We believe that all codes, arrangements and standards that affect the delivery of future strategic change in the GB energy market should be in scope. But that may mean that some of the (minor) codes, agreements or standards could be considered as licence exempt.

Our preference is that the new licensing arrangements do not perpetuate existing licensees holding code administration responsibilities. The principle of separation should be applied to the new licensing arrangement so as to avoid conflicts of interest. As it will be some time before Ofgem is granted the powers to license code managers and delivery bodies, we urge Ofgem to spend time developing (in conjunction with its stakeholders) drafts of the types of new licences (including the structure, format and clauses for these new code managers' and delivery bodies' licences) and whether there should be a class of 'licence exempt'.

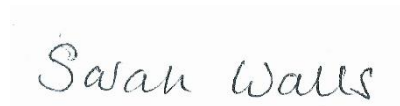
Model 3 is the only appropriate approach for the competitive tendering and licensing for the new code manager and delivery body licences. All codes (or agreements or standards), irrespective of their size, should follow this approach, noting that Ofgem will require the support from the existing Code Panels to be successful.

Ofgem has the skills and knowledge from its own representation at Panels and from managing its existing veto powers over change proposal/ modifications to develop a strategic direction (for code development) statement and to oversee the coordination of multi code changes. The consultation uses the language of 'strategic direction' but this needs to be a vision of how coordinated code development will facilitate sector change, rather than a vision for sector change which is a responsibility held by BEIS.

We believe Ofgem should lead and facilitate the consultative board with the support of industry parties, code managers and delivery bodies. It is only with this clarity of purpose and leadership by Ofgem that industry parties will be able to deliver a joint industry plan for the co-ordination of code development.

We include responses to the detailed questions in the consultation in Annex 1, appended.

Yours sincerely

A handwritten signature in black ink that reads "Sarah Walls". The signature is written in a cursive, slightly slanted style. The background of the signature area is a light beige or cream color.

Sarah Walls
Head of Economic Regulation

Annex 1: Our detailed response to the questions raised in the consultation

Chapter 2: Scope of the new arrangements

2.1. 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?

We agree with the CMA that the current code governance arrangements are not fit for purpose as they fail to deliver co-ordinated significant industry change, even with the clarity of the CACoP requirements. But we believe that the licensing for code management and delivery service should apply across all codes and agreements, not only where there is an impact on the delivery of future strategic change but including those associated standards or supporting delivery systems that are enablers for the strategic change. For example we see the DTS as an enabler of change and as such should fall into the licensing arrangements.

Disappointingly there is little detail on the proposed licensing arrangements. There appears to be no consistency on whether an existing code owner, as required by its licence, should continue to remain a code owner and it is uncertain on what the characteristics of a code manager or a delivery body licence would look like and what would 'licence exempt' would look like. We note that a one-size fits all approach is unlikely to work across the range of commercial and technical codes and agreements being considered in this consultation.

We would expect Ofgem to provide clarity on these issues and justify their approach in the next published Code Governance consultation.

2.2: Are there any other codes or systems that should be within scope and if so please give your reasons?

All codes, arrangements and standards that affect the delivery of future strategic change in the GB energy market should be in scope.

2.3: Are there any other factors you think we should consider when making this decision?

In our response to the BEIS/Ofgem 'A Smart, Flexible Energy System' Call for Evidence (CfE) we set out our vision for the transition to a Distribution System Operator (DSO) and we expressed our concerns that the current translation of the requirements of the new series of EU Network Codes into our GB Codes should enable, not frustrate, the development of DSOs in the GB energy market. Flexibility will be a key characteristic of the future energy market and so the licensing of code administration and delivery services should encompass the likely future market participant roles and responsibilities.

Our preference is that the new licensing arrangements do not perpetuate existing licensees holding code administration responsibilities. The principle of separation should be applied to the new licensing arrangement so as to avoid conflicts of interest.

Chapter 3: Licensing and competition

3.1: What are your views on our proposed approach of including the code manager and delivery body function in a single licence?

We agree that where the synergies between code management and delivery services are sufficiently strong, the appropriate approach is to include these elements within a single licence. There is a need to look across the codes, agreements and standards within the energy market and see whether synergies can also be delivered through possible rationalisation into a single licence.

3.2: 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?

Our preference is that all NGET's code administration and delivery service responsibilities for the Balancing & Settlements Code are competitively tendered and the most efficient and effective code manager be appointed to deliver the GB markets framework. (For the

avoidance of doubt, we believe it may be appropriate that NGET maintain this role but recommend that this it is appropriately tested to ensure ongoing confidence in the delivery of this role).

In the event that NGET is successfully awarded these responsibilities, consideration needs to be given as to how this interacts with the current proposals to introduce formal separation between NGET's existing roles as system operator and transmission owner, with appropriate steps taken to mitigate any perceived conflicts of interest.

3.3: What are your views on the merits and drawbacks of the four identified models for competitively licensing code management where applicable?

We see Model 3, with Ofgem managing the tender process and granting the licence, as the only viable approach. Within this model we would expect the existing Code Panels to assist with the specification of the functions and requirements for the each licence and support the tendering process. None of the other models deliver the control, transparency, value for money and efficiency required for managing a competitive licensing code process to fulfil the requirements of the CMA's recommendation.

3.4: What are your views regarding which model(s) may be appropriate for different codes, or types of codes?

Model 3 is appropriate for all codes (or agreements or standards), irrespective of the size of the code, however Ofgem will require support from the existing Code Panel.

Chapter 4: Strategic direction

4.1: Do you agree with the purpose of the strategic direction?

There is a clear case for a strategic direction for code development as significant industry change is unmanageable without cross code co-operation and co-ordination. We would welcome an annual publication of the strategic direction statement by Ofgem that signals the direction of travel for code development and details how code parties will assist with the development of the commercial and technical codes in delivering BEIS's and Ofgem's strategic objectives and policies. We highlight that the strategic direction statement should always refer to code development in the title otherwise this ambiguity could lead to misunderstanding as to the nature of the strategic direction.

4.2: Do you have any views on how the strategic direction should be developed and implemented?

The process that Ofgem follows in the development of its Forward Programme seems an appropriate process to follow for the new strategic direction for code development statement. If drafted, consulted on and published in parallel with Ofgem's Forward Programme, it gives full transparency to the linkages between the Ofgem's key work programmes and the read across into the codes. The two stage process of developing a draft and consulting on it gives the opportunity for all interested parties to comment on the content.

4.3: How much detail do you consider should be included in the strategic direction?

Unlike the Ofgem Forward Programme we would expect the strategic direction for code development statement to set out the vision but also detail the need for (ie the 'why'), the impact on (ie the 'who') and some indication of the change (ie the 'what'). It is only with this level of detail that readers can get a sense on the complexity of the change and the co-operation and co-ordination required to deliver the vision. This will also assist stakeholders to understand and appropriately plan for the resource requirements necessary to deliver the proposed change.

We believe Ofgem has the capability to provide this detail as it has a representative on the Panel of the majority of commercial and technical codes and has a group of internal experts that approve modifications and change proposals for the codes.

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

Ofgem's Forward Programme for 2016-17 is a good starting point but potentially has a narrow view as it is considering only a single year. We envisage that the statement should include all the known projects and likely industry developments for the next 3 to 5 years. For the consultative board to be able to deliver a joint industry plan for code development then there must be clarity on the order of priority and the proposed timescales for delivery.

Chapter 5: Consultative board

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

The key role of the consultative board has to be the coordination and facilitation of the cross code changes that deliver the vision set out in the strategic direction (for code development) statement. We agree that the consultative board could develop and publish a joint industry plan detailing the coordinated delivery of significant change programme, but the real issue will be prioritisation of the changes, which has to be set down in the vision of the strategic direction (for code development) statement. After developing the joint industry plan the consultative board will monitor and report against its delivery.

Ofgem has the skills and knowledge from its own representation at Panels and from managing its veto powers over change proposal/ modifications to develop a strategic direction (for code development) statement and to oversee the coordination of multi code changes but has chosen not to in the past. We believe Ofgem should lead and facilitate the consultative board with the support of industry parties, code managers etc. With Ofgem acting as the secretariat they can monitor and report delivery of the joint industry plan (for the co-ordination of code development) and publish all reports in the same transparent manner as all Ofgem documents.

Initially the consultative board must consider those projects/programmes which are in flight and previously identified near term issues but over time, as the knowledge and experience of its members grows, it will be able to consider how to oversee the change for tackling long-term issues.

We believe it is vital that Ofgem is actively involved in the consultative board to ensure it focuses on the key strategic changes required within the sector otherwise there is the potential that the consultative board focuses on any 'preferred projects' of its members.

Chapter 6: Moving to new arrangements

6.1: What are the main impacts of the proposed new arrangements on existing projects?

The issues for existing projects will be the introduction of the new licensing arrangements, the introduction of the strategic direction (for code development) statement and the consultative board. All could be potentially disruptive to the code administrators and service delivery parties delivering current change programmes, in terms of resources to manage the introduction of new arrangements and new or enhanced relationships. Care must be taken when overlaying these new arrangements to ensure that delays and/ or increased delivery costs for the projects don't significantly change the value of the business case.

6.2: 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.

Both Ofgem existing SCR powers and the CMA's proposed remedies to initiate and prioritise strategically important modification proposals appear to deliver the same required outcome. It is however unclear how BEIS will deliver the CMA's proposed remedies so it is difficult to affirm whether the new powers will make the existing SCR power obsolete.

6.3: What are your views on staggering the implementation of competitive applications for licences?

Phasing its implementation is a sensible way of introducing the new licensing arrangements. As it will be some time before Ofgem is granted the powers to licence code managers and delivery bodies, we urge Ofgem to spend that time thinking about and developing with key stakeholders:

- the types of new licence for code managers and delivery bodies, including whether there should be a class of licence exempt,
- the structure, format and clauses for these new licences, and
- a proposed programme for the phased introduction so that there is visibility to existing code administrators and aspirational code managers and service delivery bodies of the likely timetable so they are able to prepare for the expected competitive tendering process.