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30 January 2017

Dear Laura,

### **Joint Office response to the Code Governance Remedies Initial Consultation**

Thank you for the opportunity to comment on Ofgem's initial views about implementation of the recommendations proposed by the Competition and Markets Authority following their Energy Market Investigation. Please find below the Joint Office of Gas Transporters (JO) responses to your questions, noting that this letter contains the opinions of the JO only.

The JO is the Code Administrator for the Uniform Network Code (UNC).

In compiling our responses to this consultation we identified a number of associated areas (outlined in 'Other Considerations' on page five of this letter) that didn't fit into the proforma questions. We suggest that further consideration of these areas could easily be accommodated in this governance review.

At Ofgem's Code Governance workshop on 12 January 2017 several parties from a range of industry perspectives (including code signatories, transporters and code administrators) voiced concerns that the initial proposals might not be the most effective and efficient way forward. We agree with these views and have therefore taken this opportunity to illustrate how an alternative solution – a strategic design and change 'authority' – might achieve the same outcomes with minimal intervention in the smooth operation of codes. This can be found on page seven below.

## **CONSULTATION QUESTIONS**

### **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?**

**JO comments:** We agree that the CACoP codes and their associated central system delivery functions comprise an appropriate scope.

**Question 2: Are there any other codes or systems that should be within scope and if so please give your reasons?**

**JO comments:** We have not identified any further codes at this time.

**Question 3: Are there any other factors you think we should consider when making this decision?**

**JO comments:** Whilst we agree with the overall scope, we have some concerns about the groupings shown in table 1 on page 13 of the consultation document. Ofgem has identified the NETSO codes separately in Group 1 on the basis, we understand from subsequent conversations, that there is a single controlling body in place who is already licensed for these

activities. We believe there is little practical difference between this description and the arrangements in place for the UNC, where the large gas transporters – the ‘code owners’ - have explicit obligations within Standard Special Conditions A11 and A12 of their Licences to provide the UNC and to cooperate in the provision of code administration via the JO. The JO is then enabled through the Ofgem-approved Joint Governance Arrangements Agreement (JGAA) and its governing committee (JGAC). We observe therefore that Ofgem has near-parallel line of sight to that described for NGET in the JGAC/JGAA.

We believe that the proposed approach of strengthening the licence conditions for the NETSO codes should be an option considered for all of the codes in the first instance.

We recognise that the picture is somewhat more complicated in that transporters do not similarly directly control the delivery body – Xoserve, soon to be recognised as the Central Data Service Provider (CDSP) - now that full implementation of the Funding Governance and Ownership (FGO) changes have been directed by Ofgem. With more industry involvement in the decision-making processes relating to central systems and services, the Code Governance proposals could have the undesired effect of negating the innovation introduced by FGO.

Further, once Xoserve is established as a cooperative operation / CDSP, it follows that any single licence for CM/DB would be likely to bring the CM into a similar cooperative governance model. This appears to us to be contrary to the intent set out by Ofgem in this Code Governance consultation.

We would like to understand how Ofgem envisages that a single CM/DB licence holder would remain true to its Licence whilst maintaining the innovative cooperative governance being introduced under FGO that allows Users direct control over the central data services they receive.

## **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?**

**JO comments:** Taking into account the governance concerns discussed above, we only see small potential synergy advantages from a single CM/DB licence for the UNC. On balance, we do not believe it is appropriate to create single integrated licences.

As is the case for several current code administrators, the JO has true independence from all vested interests in the UNC and we are trusted to impartially facilitate, and challenge for that matter, all parties’ viewpoints. This is very popular with industry parties, as can be seen from the number of indirect, UNC-related, roles we are asked to take on where independent chairmanship is seen to be required.

Further, we believe that there is a real danger of diverting the commercial debate that is both necessary and appropriate when considering changes to the UNC. How those rights and obligations are delivered – often seen as a systems impact, or DB role - should, in our opinion, be the consequential discussion to settlement of the commercial rules. We would accept that the current processes are somewhat weaker in reviewing UNC changes in light of subsequent (systems) deployment decisions to ensure that change is efficient and effective. We are mindful that much of the industry opinion in recent years has indicated that code development timescales are too long and we have taken steps to accelerate change. There is a real risk that this could be reversed should detailed systems impact assessment and costing become an integral part of the change mechanism as would be likely under an integrated single licence.

Lastly, we observe that the people undertaking these roles for the UNC are employed by different organisations and bringing them together under a single body would be a significant change to employment arrangements. The added complexity and time should be factored in to Ofgem’s considerations.

### **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?**

**JO comments:** We offer no opinion on the appointment route of the code manager for NGET codes, only that there should be consistent treatment for all similarly-governed code managers (as per Chapter 2: Q3).

**Question 3: What are your views on the merits and drawbacks of the four identified models for competitively licensing code management where applicable?**

**JO comments:** We agree with much of Ofgem's discussion in the consultation document and, in particular, that Model 3 (Ofgem tender process and licence granted to the winner) is likely to be preferable for many codes.

We do not believe that it is appropriate for other bodies (than Ofgem) to operate a tender process under either permissive or sole provider licensing. Please see our general comments below that set out our thoughts on the roles that might be assigned to the UNC Modification Panel under these arrangements. We agree that an amount of wider industry input is desirable and note that there are successful examples where stakeholder involvement in qualification and shortlisting activities has worked well without causing conflict with procurement rules (such as for the gas industry 'Allocation of Unidentified Gas Expert' – AUGE).

At this stage, we do not believe that permissive licensing would suit an organisation like the JO, which is an agent of the transporters. We do not foresee at this point any aspiration to be involved in other codes and therefore pre-qualification to any basic requirements would potentially be a waste of time and resources.

Finally on permissive licensing, we observe that this type of mechanism only works well if there is sufficient competitive tension to produce effective competition for licenses. We can see that the quoted examples for offshore electricity transmission demonstrate Ofgem's point – which is to be expected since these are asset-heavy investments with long-term returns for investors – but we do not see a parallel for code management, which is lower value, intellectual-property aligned and dependent more on the skills and knowledge of individuals.

**Question 4: What are your views regarding which model(s) may be appropriate for different codes, or types of codes?**

**JO comments:** For large and complex codes with significant delivery systems we would anticipate that Model 3 would be appropriate.

Smaller codes, with small or limited systems impacts could follow Model 1.

As stated above, we do not agree that permissive licensing conducted by a non-Ofgem party is appropriate, which, in our view, removes Models 2 and 4 from scope.

**CHAPTER Four: Strategic direction**

**Question 1: Do you agree with the purpose of the strategic direction?**

**JO comments:** We agree with Ofgem's views that a strategic direction would be an effective way of setting expectations; aligning priorities and objectives; and enable a sensible industry discussion about deployment of resources.

**Question 2: Do you have any views on how the strategic direction should be developed and implemented?**

**JO comments:** Ofgem's proposals appear to be sensible, providing a balance of content and efficient process. We feel that the development of the strategic direction, to provide industry with a coherent vision for change, should be the main priority at this time. We believe it is imperative for the success of other aspects of the work programme to understand what the strategic plan should contain and what the role and responsibilities of stakeholders should be. We agree with Ofgem's anticipated production of a first draft by late 2017 and that, in the long term, it could inform whether changes are required to licences or industry codes.

In process terms, we believe that there is merit in consulting widely, in addition to having input

from the Consultative Board, on the content of the strategic direction as this is likely to engender more shared ownership of the deliverables.

**Question 3: How much detail do you consider should be included in the strategic direction?**

**JO comments:** It would seem sensible to use the Forward Workplan published by the Code Administrators in January 2017 as a starting point for this work.

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

**JO comments:** See Question 3 above.

**CHAPTER Five: Consultative Board**

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

**JO comments:** We agree with Ofgem that, going forwards, it will be important to co-ordinate and prioritise cross code change that benefits consumers. We feel that the role and remit of the consultative board needs careful consideration and we have some concerns in this regard. However, we support the consultative board being established by early 2018 in order that they can review the first draft of the strategic direction in order for them to develop and maintain a joint industry plan.

We note that Ofgem anticipate that the Board will act in an advisory capacity, however we feel that there could be significant benefits from having more explicit responsibilities for the Board in respect of delivering strategic change; such as clear, single, decision-making and accountability, full representation (including consumer representatives) and a real focus on what needs to be done.

Such a remit would need careful consideration, since it introduces the possibility of conflicts with individual code Panels, and possibly with Licence obligations on parties. We would like to work with Ofgem to consider how binding decisions could be taken, and actioned, in the proposed regime. For instance, we note several references to commissioning work for the Code Manager, and we think it is important to provide absolute clarity about how the various governance bodies will complement each other and avoid conflict. This is especially important where decisions have expenditure and/or funding consequences for CMs and/or DBs.

Turning to the list of functions envisaged in Table 6 of the consultation document, we think it could be an overly ambitious remit for a voluntary body (that implies limited meeting time). In our opinion, it is likely that the volume of large and complex change ahead of the industry will fully occupy the available time for the Board in the medium term and perhaps the functions should be split to focus on immediate priorities.

On an associated point, we think that the effectiveness of the Consultative Board will be largely dependent on the quality and level of administrative and process support it receives. We observe that similar central governance bodies operate at their best when there is dedicated programme support, who are dedicated to the decision-making needs of the body and therefore supply timely and concise input reporting and then ensure action is taken on the decisions made. We would encourage Ofgem to consider how this might be achieved in the best interests of the Board and stakeholders.

**CHAPTER Six: Moving to new arrangements**

**Question 1: What are the main impacts of the proposed new arrangements on existing projects?**

**JO comments:** This is a difficult question to answer at this time, given that the regime and the projects in scope are uncertain.

We agree with Ofgem that the existing governance for inflight projects should be allowed to

continue, however there appears to be merit in the Consultative Board taking some sort of monitoring role, not least in terms of helping it to settle in to its role and to enable sensible decisions to be taken about prioritisation of new projects that will be wholly within the scope of the Board's powers.

**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.**

**JO comments:** We tend to agree that conventional Ofgem-led SCRs should become obsolete once the new arrangements are fully active. More consideration should be given to whether this means that the powers should be removed completely, or retained (in a simplified 'SCR-light' form that allows Ofgem to shape and/or direct change without actually conducting the development work) as the ultimate backstop.

Equally, we feel that there could be merit in something akin to an SCR to oblige parties to engage in, and deliver, strategic change via the CMs.

**Question 3: What are your views on staggering the implementation of competitive applications for licences?**

**JO comments:** We recognise the benefits of developing a process to both ensure the best code managers are appointed to conduct the role and to facilitate the consolidation of these bodies. However, we feel that full licencing and competition should only be considered further after reinforced obligations on existing responsible parties have been completed and if an Impact Assessment identifies further benefits of moving from a regime of strengthened licence conditions to full competition.

## **OTHER CONSIDERATIONS**

### **Code owner**

We note that Ofgem is considering a requirement that the Code Manager also becomes the code owner whereas, in the case of the UNC, this is currently the responsibility of the gas transporters. We understand this could be a natural and desirable product of the move towards CM, however we wanted to highlight the associated additional responsibilities we foresee when transitioning from the current code administration role into CM.

Being a code owner brings with it responsibilities to be the 'subject matter expert' (SME) and legal text provider for all parts of the code. It is our experience that the provision of such legal text and SME support in interpreting/facilitating the dialogue between change proposers and lawyers is essential to a well-functioning change process. Further, given competitive licensing is the preferred way forwards, we have concerns that providing appropriate specialist skills and knowledge to support CM activities might be challenging, since they do not currently reside in the JO.

We look forwards to working with Ofgem to understand more fully the issues associated with this aspect of the proposals.

### **Costs and funding**

At this early stage we appreciate that it is too early to consider costs and funding arrangements. Again this is an area that needs careful consideration to ensure that measures taken are proportionate. For instance the JO, as an agent of the gas transporters, does not need to directly employ the overheads you would normally associate with running a licensed business (sharing in the economies of scale of the transporters and attracting only their related incremental costs). This ensures that the costs of code administration – which ultimately pass through to consumers via transportation charges – are kept to a minimum.

We have concerns that the perceived benefits of competitive tendering are somewhat obviated by the additional overheads that become necessary and we wonder if a full Regulatory Impact Assessment is appropriate here to ensure that the preferred implementation method is in the best interests of consumers.

## **Project Management and Assurance (PMA)**

We note that Ofgem's Code Governance Review Phase 3 (CGR3) introduced a requirement on code administrators and Panels to work towards implementing PMA arrangements that could be deployed in the event of complex change. There is little specific mention of these activities under the new CM proposals, however we expect that this should be seen as inherent in '...ensuring effective code change...'.

We would appreciate Ofgem's confirmation that they see 'change' in its macro form for the purposes of these arrangements; from code legal text right through to go-live of the arrangements with systems as appropriate.

## **Cross-Code change**

The document contains several references to coordinated cross code change, which is a sensible step where there are dependencies between such codes. It follows that, in each instance, one CM should take the lead role to ensure there is coordinated effort. It is not clear to us how such decisions would be taken, particularly as it is likely that any given CM would not be resourced to support wider development and implementation activities than their own code.

We would appreciate more information as to how Ofgem envisages this cross-code coordination working.

## **Code Manager powers to act**

Where strategic change is required, and an SCR is initiated, we believe that one of the things that makes parties mobilise resources is that it is Ofgem directing matters. We understand that licences would be changed to include obligations relating to these new arrangements, which would be the ultimate means of driving behaviours, however we do not currently understand how a CM would be empowered to drive strategic change in real time.

We would appreciate more information as to how Ofgem envisages this working in practice.

## **UNC Modification Panel (Panel)**

The Panel comprises elected Shipper representatives and appointed Transporter and Consumer representatives. Currently, on its existing scope of 'governance of UNC change', members can expect to be engaged for one and a half to two days per month on Panel business (approaching 10% of their total working time). Most members also attend workgroup meetings.

We have some concerns that increasing the responsibilities of Panel to include planning, delivery governance, tendering and other roles that are essential to these proposals will divert increasingly-scarce industry resources away from workgroups and cause delays in the assessment of modifications.

We accept that there are important roles necessary for industry participation and we look forward to working with Ofgem to consider what can be done to increase participation levels such that the burden does not fall solely on the few.

## **Time to implement**

As described in this consultation response, we believe that there is much that is good about the proposals however we would question the need for such comprehensive and potentially costly structural change to the arrangements to achieve it. With this complexity comes an elongated timeline for implementation and we take this opportunity to encourage Ofgem to consider whether the majority of the benefits can be instead achieved by simpler means, such as some form of binding Memorandum of Understanding for all industry parties to commit to. This could be supported by a reinforced CACoP to ensure that code administration becomes even more consistent and coordinated.

It is our belief that, with the backstop of licensing always a possibility, industry would prefer (and support) a more rapid implementation via agreement and this would ultimately be to the greater benefit of consumers.

## **ALTERNATIVE ROUTE TO ACHIEVE STRATEGIC CHANGE**

We note that there was reasonable support at the Code Governance Workshop on 12 January 2017 for the adoption of a central 'strategic design and change authority' instead of licensing all CM/DBs. We agree with the views expressed; it appears to meet the key objectives Ofgem seek to achieve in this review without material change to operating structures that the industry is used to.

We would expect the remit of such a central body to include:

- the development and promotion of the industry Forward Workplan
- facilitation/support for the Consultative Board, including providing meeting inputs and ensuring actions are delivered
- ensuring that the consequences of any design decisions resulting from the Strategic Direction are identified and addressed
- driving change centrally, operating an SCR-like process where required for coordinated change.
- the ability to raise code modifications where necessary
- assurance of the integrity of change programmes, including the delivery of change through structured project management and assurance
- being the industry's 'informed buyer' of project management and assurance services

This body could be licenced and/or competitively tendered to ensure that Ofgem's Strategic Direction is delivered in the most efficient way.

Having a single central organisation would potentially provide more transparency of the costs incurred and potentially make funding a simpler process.

Existing Code Administrators and Delivery Bodies would need to support such a strategic change body and we believe that a combination of Licence amendments (for NETSO / UNC and other similarly-licenced transporters) and changes to the CACoP and/or code rules (as has happened in, for instance, Ofgem's Code Governance Reviews) could achieve this cooperation.

We believe there is merit in investigating whether the establishment of a strategic change body better facilitates the requirements set out by the CMA and we look forward to supporting Ofgem in the coming months in assessing all of the options.

I hope I have addressed adequately the points you are interested in. Please do not hesitate to contact me on 07909 686661 if you would like to discuss anything in this letter.

Yours sincerely,

Les Jenkins (*via email*)

Chief Executive, Joint Office of Gas Transporters