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Code Governance Remedies
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Dear Laura,

Consultation on implementing the Competition and Market Authorities recommendations for Industry Code Governance Remedies

Thank you for the opportunity to respond to the consultation on implementing the Competition and Market Authorities (CMA) recommendations for Industry Code Governance. This response is made on behalf of National Grid Gas Distribution Limited (NGGDL) and can be published by Ofgem.

NGGDL is a gas distribution company providing gas to 11million homes and business through 130,000km of pipelines. We own and operate four regulated gas distribution networks covering a geographically defined service territory that spreads across the East of England, North London, the North West and the West Midlands.

While NGGDL has addressed each of the consultation questions in turn, there are a number of observations arising from both the consultation document and the Ofgem seminar of 12 January 2017 that we wish to bring to Ofgem's attention.

NGGDL supports both the scope of the proposed review and developing a strategic approach to industry change. Ofgem will be aware we have been a strong advocate of managing change within a strategic context, particularly given the pace, complexity and diversity of change that the industry has and is currently experiencing. This is likely to continue, if not increase and in the absence of a coherent strategy, accompanied by unambiguous priorities, collectively there is a risk that the industry may not be able to deliver the improved outcomes and services that customers need.

We note that the consultation document identifies a significant risk around delivery of some of the proposed remedies due to insufficient government time being available to prepare and enact through parliament relevant legislation to provide for licensing of Code Managers and potentially Code Delivery Bodies. This risk is likely to be further increased by the inevitable focus on the UK leaving the European Union and any consequent legislative programmes. Indeed this was reinforced at the 12 January 2017 stakeholder event where Ofgem indicated that the Department of Business, Energy and Industry Strategy (BEIS) were unable to confirm if they could schedule time before the next election. However, this issue should not prevent Ofgem and the industry developing new frameworks and models for industry code governance, but clearly the desired objectives may be limited in the absence of relevant licences. To that end we would recommend that, unless BEIS indicates otherwise, the draft proposals are reviewed to assess what can be delivered on a 'no regrets' basis such that key features of the CMA recommendations are implemented where possible and where not, that they are capable of implementation once the intended legislation is forthcoming.

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Notwithstanding the direction Ofgem decides to take, it is vital that the review doesn't confine itself to the narrow aspects of the roles of Code Managers, Code Delivery Bodies and Consultative Boards as whether licensed or not, there will be consequential impacts on the licence obligations of Gas Transporters and potentially other licensees. As we have raised in the current Xoserve Funding Governance and Ownership (FGO) review, obligations must be capable of being managed and controlled by the relevant licensee. Ofgem will need to provide clarity on the licence obligations of all parties as misalignment between obligations and control will lead to inefficient processes and avoidable costs to consumers.

We support the concept of Licenced Code Managers and Delivery Bodies but are mindful that the anticipated scope for Code Managers is significantly wider than the existing arrangements in gas where the Joint Office of Gas Transporters provides an efficient, low cost code administration service to the gas industry. This issue would need to be examined carefully to identify a solution that builds upon the existing strengths and meets the needs of gas transporters, shippers and their customers. In that regard the respective roles of Xoserve and the Joint Office should be considered carefully so that organisational relationships can be addressed.

Related to this we note the consultation envisages the possibility of cross code managers and delivery bodies. However, we believe that while energy market strategy should encapsulate both electricity and gas, the role of a Consultative Board being a key element of this, it should be possible and indeed may be more efficient to maintain discrete gas and electricity management and delivery. Taking this approach would mean that both sectors could focus on delivering their associated priorities in the strategic plan but, at the same time the Consultative Board would then be best placed to facilitate cross sector best practice to drive value for consumers. The alternative could risk necessary change in one sector being inappropriately applied to the detriment of the other. We strongly advocate that irrespective of the model, the final decision is justified on a sound cost benefit basis.

Please see below our answers to the consultation questions. In the meantime if you have any further questions please do not hesitate to contact me using the details at the top of this letter.

Yours sincerely
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Appendix 1.0 **Responses to Consultation on implementing**
CMA's Recommendations for
Industry Code Governance Remedies

Chapter 2 - Scope of 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?

Response: Yes we support this approach as well as the inclusion of the core systems delivery function, as this would be key to implementing the changes required to drive the benefits of any proposed strategy.

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

Response: We have not identified any other codes or systems which we believe should be within scope.

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

Response: We have not identified any other specific factors. Whilst we support the overall approach to scope and function, we also recognise that it may not be possible to schedule parliamentary time to enact the necessary legislative change for the new licencing regime. This should not prevent any new arrangements being developed in the interim on a 'no regrets' basis and the desired objectives should be capable of being implemented when the intended legislation is forthcoming.

Chapter 3 - 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?

Response: In broad terms we would support the concept of a code manager and delivery body function to support the overall strategy and in particular the relative merits of a single or combined licence should be explored. In the gas industry this has particular importance in relation to the Joint Office of Gas Transporters as that organisation is currently not resourced to carry out the proposed Code Manager role and therefore the future relationship between the Joint Office and Xoserve should be explored carefully both in a licensed and transitional framework, such that any solution builds upon the existing strengths and the organisation weaknesses can be addressed.

It should also be recognised that any new arrangement must enable Gas Transporter's to fulfill their existing license obligations and Ofgem should provide clarity on the specific licence obligations for each party.

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?

Response: This seems a sensible approach and we are broadly supportive.

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

Response: In relation to the permissive licences we accept that this would potentially introduce competition for codes. However, in the event that this approach was adopted, any licence granted must include conditions requiring compliance with the relevant service contract. In the event that this is not considered then the required strategic change and benefits to consumers would not be realised.

Sole provider licences would appear to be a more robust mechanism for ensuring that the body best placed to deliver the function can do so given that they will also be directly accountable for delivering the required licence obligations. Inclusion of requirements, incentives and revenue settlements directly within the licence would seem a more robust mechanism for delivering the required changes (rather than the more complex service contract). The measure could also lead to more timely initiation of code changes as it negates the need for further contractual arrangements to be concluded. The initial tendering process would ensure that organisations could demonstrate added value and potential costs savings so that licences are awarded to those that can actually provide the required service.

Of the models proposed our preference would be for Ofgem to maintain a role in the cycle to ensure focus on the strategic direction and introduce consistency in licence awards. We would support setting clear requirements and incentives on code managers and delivery bodies to deliver strategic change through direct licence obligations (Model 3) rather than service contracts (Model 1).

It would also be prudent to review existing licence conditions to ensure that delivery of the obligations ultimately sits with the party that can directly influence the activities. This would be likely to involve a review of relevant gas transporter, supplier and shipper licence conditions. An example of the transporter obligations that relate to market activity is Standard Special Condition A14 (Supply Point Administration Agreement - SPAA).

We note that at its recent Code Governance Stakeholder Event, Ofgem highlighted that it had concerns over a lack of parliamentary time to raise relevant legislation to enable licensing. Therefore we strongly recommend that Ofgem re-appraises its approach and assumptions such that where possible a framework is developed that can operate in the absence of licensing but is capable of being moved into a licenced structure relatively easily. An alternative would be to leave code governance as currently exists, but develop a model that can then be implemented when primary legislation is enacted.

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

Response: In the case of gas contracts our opinion is that the UNC could be managed through model 1 or 3.

In the case of a tender being awarded to a cross code delivery body we believe there would be a need for gas and electricity activities to be managed as discrete entities under the single code manager. Taking this approach would mean that both sectors could focus on their priorities but at the same time it could be used to facilitate cross sector best practice.

Regarding the key areas outlined for further work in the consultation we agree that these are all key considerations as well as the need to understand the impacts of new licence regimes upon existing arrangements.

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Chapter 4 - Strategic Direction

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

Response: In general we support the purpose of the strategic direction as this would ensure that industry focus is channeled appropriately to deliver consumer benefits, assuming that relevant licence obligations are aligned to deliver the appropriate outcomes. For a considerable time the efficient and timely delivery of beneficial industry change has been adversely affected by the absence of a comprehensive strategic plan which clearly identifies, evaluates and prioritises change which is for customer benefit. This has overly burdened the industry and availability of qualified resources to drive change. There has been little recognition until very recently that volume of diverse change itself is a significant factor. Consequently we strongly support Ofgem's proposals in this area.

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

Response: We agree with the CMA that Ofgem should be responsible for setting the cross cutting strategic direction for development of industry codes Regulatory Impact Assessment route could be a useful model approach in this regard). We also agree that this should be centered on providing benefits for consumers. Ofgem's proposals to publish a draft strategic direction in the Autumn of 2017 should provide a platform for all stakeholders including consumers to participate in shaping the strategy and priorities over the longer term. However, strategic planning can't operate in a vacuum and will need to be continually reviewed and where necessary amended as developments occur, for instance in energy policy or technological change. Strategic reviews should therefore be conducted at least once a year to ensure the strategy remains relevant and where necessary Ofgem should be prepared to re-prioritise or re-phase where necessary.

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

Response: The strategic direction should be sufficiently high level to outline what is required and by when and associated benefits to consumers. The detail is something that should be agreed by Code Managers and Delivery Bodies as they are best placed to review potential solutions and suggest the most appropriate solutions that will meet the requirements in the most cost effective way. This would need to be carefully governed to ensure that the strategy was being met. In addition to the items highlighted in the consultation paper it may be prudent to rank initiatives in order of priority and this may lead to some difficult decisions in some cases.

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

Response: From the perspective of the gas industry, we would expect that an assessment of current major projects such as the Xoserve Funding, Governance and Ownership Review, Project Nexus, CMA recommendations on Code Governance, Smart Metering/DCC and Ofgem's Faster Switching programme would form the starting point to assess the current change in landscape. The strategy itself should then consider horizons from five to ten years and potentially beyond consistent with government climate change objectives. Within the shorter term period the potential impacts of the UK's withdrawal from the European Union should be considered. As mentioned previously, innovation and technological change should be examined as well as likely consumer and broader energy market developments, e.g. the inclusion of hydrogen in the Future role of Gas.

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Chapter 5 - Consultative Board

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

Response: Our opinion is that the Consultative Board could have a key advisory and guidance role. In particular we believe that the board would act as a conduit between the industry, consumers and Ofgem in terms of both developing strategy and advice and guidance to Code Managers and Code Delivery Bodies. The new Xoserve board under the Funding Governance and Ownership review is already demonstrating the strength of diverse industry representation. A Consultative Board that utilises diversity from across industry and consumer bodies could bring real value to the new framework. Crucially the Consultative Board should be looking cross code at developments in electricity and gas to ensure that where appropriate change is co-ordinated. Equally it should ensure that developments in one sector are not carried over to the other where no or little benefit can be justified. We strongly advocate that irrespective of the model, the final decision is justified on a sound cost benefit basis.

Chapter 6 - Moving to new arrangements

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

Response: We agree with the conclusion in the consultation in that the proposed reforms are unlikely to affect the governance of these programmes of work directly and they should continue under their current governance processes. However it would be prudent for Ofgem to provide clarity on this.

We also agree that other work programmes may begin in the intervening period and that these programmes should not be unduly delayed. There is no reason why before commencing that they are first reviewed to assess levels of priority and available resource to support them. Associated with this is that additional programmes of work and their implementation will need to be monitored to ensure that the changes to code governance do not impact adversely on delivery.

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.

Response: The relevance of SCR's powers in the context of Ofgem's proposals should certainly be reviewed and either incorporated in any potential new code governance framework if found to be beneficial or removed if not. We see no benefit in leaving surplus powers in place on the basis that they might be needed at some undefined point in the future.

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

Response: There may be benefits in staggering competitive applications for licences, but this would depend critically on whether a licencing regime was available in the first place and if it were, how comfortable Ofgem would be with the robustness and maturity of the new framework design.

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