



St Lawrence House
Station Approach
Horley
Surrey
RH6 9HJ

Laura Nell
Code Governance Remedies
Ofgem
9 Millbank
London
SW1P 3GE

By email to: CodeGovRemedies@ofgem.gov.uk

1 February 2017

Dear Laura,

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

Thank you for the opportunity to respond to your consultation in relation to the above¹. We have provided some general observations and have also responded to each of the questions as structured in the consultation document, in order to facilitate ease of comparison with the feedback of other industry parties.

SGN is actively involved in the ongoing management and development of several industry codes, including the Uniform Network Code (UNC), Smart Energy Code (SEC) and Supply Point Administration Agreement (SPAA). We are also licencees under the Gas Distribution licence. We are involved in a large number of industry change initiatives, not limited to Project Nexus, Faster Switching, Smart Roll-out and the Funding, Governance and Ownership Review (FGO) of Xoserve. We are also engaged and involved in the management of Xoserve as central system provider and the Joint Office of Gas Transporters as code administrator. We participate in the committees and working groups associated with these codes and initiatives with a commitment to the positive development of industry changes to benefit the end consumer.

SGN look forward to continuing to engage with code bodies in a constructive manner to ensure that the industry continues to operate efficiently and in the consumers' best interests.

General Observations:

We consider that the new arrangements provide the industry with an opportunity to implement some strategic principles to lay the foundations for likely future code governance reform. The future arrangements should create a mechanism whereby policy objectives can be set by BEIS and Ofgem and will follow a clear line of accountability through to delivery. We accept that it may not be possible or prudent to implement significant code reform immediately due to limited space on the legislative timetable, however we think that the definition of clear governance principles at this point is important to ensure that code bodies understand the direction of travel and can prepare accordingly.

¹ https://www.ofgem.gov.uk/system/files/docs/2016/11/industry_code_governance_-_initial_consultation_on_implementing_the_competition_and_markets_authoritys_recommendations.pdf

We would suggest that these principles include;

1. Common principles for evaluating change.

There should be established common principles of evaluating change that are shared across all Code Management bodies, including a thorough cost-benefit analysis and frequent re-assessment of the associated underlying assumptions. Throughout the development and delivery of a change, a demonstrable focus on consumer benefit and alignment with the prevailing political objectives should be seen. Furthermore, there should be a common suite of criteria to identify the strategic materiality of a given change, thus enabling a collaborative approach to significant changes while preserving the flexibility to progress non-strategically material changes quickly. This will assist in ensuring the Strategic Direction is robustly delivered and is focused upon the most strategically-critical changes.

2. Alignment of multi-party delivery.

In changes deemed to be strategically material and of a certain level of complexity, there should be a specific focus upon a successful and timely integrated delivery, including close management of, and engagement with, any cross-industry testing. This approach should be enforced by a Delivery Coordinator role, with sufficient vires and mandate to compel the relevant industry parties to drive a synchronised delivery.

3. Consolidation of Codes and Code Management Bodies should align with required expertise.

It is important to recognise that there is specialist technical understanding that is pertinent to each energy sector specifically (eg gas or electricity) and we need to avoid one sector crowding out important issues in the other. Where there is a significant overlap in expertise (eg: metering, data security, or customer experience) then the codes should be combined. Similarly, where the codes differ significantly and have limited alignment in content or process, they should remain under separate structure and governance, in order to retain the appropriate representation and expertise required. Such an approach would ensure the efficient operation of each code and would avoid any complex and extraneous governance layers.

4. Alignment between financial exposure, license obligations and governance.

The license obligations should sit with the organization most able to deliver them. We need to avoid the situation where the license obligations or financial exposure of an organization are divorced.

We agree with the CMA recommendation that the provision of Code Management and Delivery Body services should be a licensable activity and would take this a stage further to state that there should be appropriate alignment between this and financial exposure when defining governance arrangements.

5. Expertise should be held within the Code Management body.

In order to effectively discharge any future licence obligations, Code Management bodies should be adequately resourced to provide the relevant expertise required for effective code management (not technical/engineering expertise). For example, they should be able to provide a robust level of understanding in order to drive meaningful development in line with the defined policy objectives, as well as the relevant legal drafting resources. An understanding of cross-code impacts would also be expected. It is expected that the high level of neutrality and independence already practiced by Code Administrators would endure.

6. Minimising the number of interfaces and handovers.

Interfaces between codes add cost, complexities and are a point of risk that often requires associated legal agreements to govern. As far as possible the interfaces in implementation should be minimized, and the understanding of such is expected to be held by the Code Management body.

SGN Response to 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?

We agree.

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

We primarily support the proposed scope, however would seek further clarity as to the justification for the exclusion of Group 3. Whilst we agree with the assessment that codes of limited content (such as the Smart Meter Installers Code of Practice) are unlikely to materially impact the delivery of strategic change, the principle of a harmonised and consistent approach to code management would lead to the conclusion that all codes, regardless of likely impact, should be included. Codes identified as having little impact would not significantly increase the resourcing requirements of the new arrangements.

Similarly, we note that the System, Security and Quality of Supply Standards (SQSS) is also proposed to be excluded from the scope of the new arrangements. The SQSS is identified as having a wide impact and therefore we would expect that, again for the purposes of harmonisation and consistency, this code would be within the scope of the new arrangements. Given that this code is not frequently modified, it would not be likely to add a significant resourcing requirement to the new arrangements.

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

Our understanding of the CMA's conclusions is that a more collaborative and harmonized approach to code management is expected to deliver a more efficient and strategic approach to change, with increase consistency and interactions between the codes. In this case, as above, we do not see a strong reason why codes would not be included, even if they are narrow in scope or rarely modified.

CHAPTER: Three: Licensing and competition

We are supportive of the principle that Code Management and Delivery Body services should be licencable activity, and that the governance and funding arrangements should evolve appropriately to reflect this. In relation to the Delivery Body in particular, we consider that the licence and management team should be sufficiently empowered to apply direction and authority to ensure delivery in line with the industry's requirements and plan.

Given the current political landscape and competing priorities, there exists the risk that the primary legislation required to deliver the appropriate licencing arrangements may take some time, however in the interim period we consider that significant progress could be made to deliver the intentions of the new arrangements, without the licencing necessarily being in place.

We are less supportive of the application of competition to these activities, not with regards the principle of competition per se, but rather due to the challenges in applying it effectively within this highly specialised sector of the industry.

We would encourage Ofgem to progress the licencing of Code Management and Delivery Bodies as a priority, and, once their position and the role of the Consultative Board have become established, to re-evaluate the case for competition.

Question 1: What are your views on our proposed approach of including the Code Manager and Delivery Body function in a single licence?

We are generally supportive of this principle, however we need to ensure that the benefits of having demarcation between the two – in terms of management, direction and accountability – are not lost. This will depend on the role taken by the Consultative Board.

While a single-licence approach may lead to more organizational consolidation, we consider that there is value in the original objectives of separating the Code Management and Delivery Body functions, in order that the former can hold to account the latter. There is then a clear hierarchy between Ofgem, the Consultative Board and the Code Manager when delivering the Strategic Direction, with the golden thread of policy objectives running throughout.

Secondly, given the variety of code governance and delivery models currently in place within the industry, we consider that a single-licence approach may be more easily applied to some codes rather than others. One important consideration here is the management ethos, as an example Xoserve can be characterised as co-operative body, whilst Joint Office can be characterised as more directive; by forcing the management body to be co-operative you could undermine its effectiveness.

Similarly, a single- or dual-licence approach is likely to have a significant impacts on the organisations involved and therefore we would seek clarity on the proposed obligations and responsibilities intended to be contained within these licences. We would also welcome detail on the consequential amendments to the existing code ownership obligations held within other industry parties' licences.

In relation to the role of Delivery Body specifically, we highlight the recent Funding, Governance and Ownership (FGO) Review and the associated supporting licence arrangements. The review has created a model in which Shippers, Gas Transporters and Independent Gas Transporters are jointly responsible for the management of the Central Data Services Provider (CDSP) function, currently undertaken by Xoserve. There are significant parallels between the role of CDSP and Delivery Body and therefore there would be considerable value in observing the practical operation of such a model as it matures, especially given the likely delay to any fully licenced Delivery Body model.

Given the desire to promote competition in the licenced functions, we would suggest that consideration is given to whether the combination of the Code Manager and Delivery Body functions under a single-licence creates the most compelling environment for competition. It may be the case that, in order to promote competitive tension, a dual-licence arrangement would enable a more accessible tender. A clear process of engagement and accountability between licensees could be created, with the Code Manager ensuring that appropriate arrangements are in place to provide a smooth handover to the Delivery Body.

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?

Whilst we consider that the approach of strengthening the existing NGET licence may be the most efficient and a relatively pragmatic approach, we are concerned whether this would be contrary to the principles of competition and harmonisation. If the intention of the new arrangements is to create consistency and harmonisation of treatment, we would expect the same competitive licencing procedure to be applied to all.

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

Whilst we are supportive of the principle of competition, at this stage we have not seen sufficient evidence that the introduction of competition into code governance will bring about material benefits. We consider that the existing arrangements are already controlled and monitored to the point where efficiency, and ultimately consumer impacts, are of utmost importance, and we are not clear on how the new arrangements will significantly improve this position.

We would also advise caution regarding the introduction of competition, in terms of the complexity and potential instability that the introduction, and ongoing operation of regular rotation of contracts could cause. As a general rule our industry values a robust, trusted and reliable service at a premium and will be concerned with the perceived risk to the quality of customer service through regular integration and process changes.

In relation to the new arrangements, we have some concerns as follows:

- 1) The complexity of the interfaces that would be necessary to bring about appropriately structured units that could be effectively tendered may be prohibitive;
- 2) The challenges in maintaining an effective pool of competitors in any tender when there are clear benefits of consolidation;
- 3) The risk to the customer with regular changes in interfaces and counterparties are arising from competition; and
- 4) The risk that there is under-investment in internal systems and staff towards the end of each competitive period.

We observe that, at this stage, Ofgem has provided a very limited evidence base to suggest that material gains could be achieved through competition. It is noticeable that the evidence base draws on OFTO financing to support the gains from competition, however we would consider that OFTOs are constructed infrastructure asset that have very limited points of comparison with code management. We would be keen for any move towards competition should be accompanied with a regulatory impact assessment to identify where the savings can be delivered, particularly where codes are currently being delivered on a not-for-profit basis.

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

At this stage we do not consider that we have sufficient clarity to make any recommendations. However, following the conclusion of this consultation we would welcome the opportunity to review industry responses and further consider the most appropriate model to be taken forwards.

CHAPTER: Four: Strategic Direction Question

1: Do you agree with the purpose of the Strategic Direction?

We are highly supportive of the Strategic Direction. We understand the purpose of the Direction to be:

- Prioritisation of concurrent industry changes
- Alignment of concurrent and future industry change to the objectives of Ofgem and BEIS
- Creation of a common industry focus, expectation and delivery plan.

There are several examples within the gas industry alone where a clear direction, in alignment with Ofgem's objectives, has facilitated the efficient, focussed and cooperative delivery of change – for example the move to 21-day switching as facilitated by UNC Modification 0477 – Supply Point Registration: Facilitation of Faster Switching².

Going forwards, we consider that the Strategic Direction will also be critical in overcoming the challenges associated with code parties each having their own competing change agendas. Similarly, it is important that the licence and management team of the Delivery Body are sufficiently empowered to drive delivery in line with the industry, and Ofgem's, requirements.

As seen with the above example, a Strategic Direction is critical to the successful delivery of significant and/or complex integrated changes requiring implementation on both central and other industry parties' systems.

² <http://www.gasgovernance.co.uk/sites/default/files/Final%20Modification%20Report%200477%20v2.0.pdf>

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

We agree that Ofgem should be the central body that issues the Strategic Direction and that this should be aligned to the overall political objectives of BEIS. However the Strategic Direction cannot be undertaken in isolation from the Consultative Board and both should work on the basis of robust consultation with the industry, and with an understanding of the relative priorities of industry parties, as well as with due regard to any 'inflight' programmes of work.

We encourage Ofgem to clarify whether the Strategic Direction will be based on, or subject to, effective cost-benefit analysis. We would encourage the later to give scope for change in direction as the costs and benefits become more clearly established. This approach may also be of assistance should the situation arise that a priority call is required.

We also consider it important that the Strategic Direction is developed and managed with a commitment to ensuring that prevailing programmes of work remain relevant and have not been superseded by a broader strategic change. This is important to ensure that changes remain in the customer interest at all times. Similarly, it is also important to create a structure wherein the customer interest can be re-affirmed on an ongoing basis and, where the benefits of a change have become diminished, sufficient empowerment exists within the Code Management, Delivery Body and Consultative Board to confidently guillotine such a change and re-direct industry efforts to a more strategically relevant programme.

As per the consultation document, we would welcome the Direction to be employed on a non-obligated basis at least initially, as we consider that adherence to the Direction is of mutual benefit to the industry and should therefore be entered into on a good faith and voluntary basis.

Question 3: How much detail do you consider should be included in the Strategic Direction?

We would expect the Direction to cover a rolling 5-7 year horizon, with greater detail in the immediate future (1-3 years) and more flexibility, with likely less granularity, in the far future (4-7 years). We would expect the direction to have due regard to the Gas Distribution price control periods, as well as any equivalent financial planning employed by other industry parties.

We consider that the Direction should also include:

- Clear objectives
- Clear drivers
- Clear assumptions, dependencies and risks
- Clear outputs and expectations
- Clear and reasonable timescales
- Clear Roles and responsibilities
- Clear and ongoing check-points of review and re-assessment

It is important that there is appropriate consultation processes that lead up to the Strategic Direction being issued to ensure that all costs and impacts are duly considered, and implementation timetables are reasonable.

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

If, as per the consultation, the initial Strategic Direction is to be published in Autumn 2017, then we would expect the following to be included:

- Faster Switching / Central Registration
- Smart Metering Roll-Out
- Potential Retail Code Reform
- Political activities considered to have potential impacts – such as Brexit in relation to EU changes.

CHAPTER: Five: Consultative board

Question 1: What do you see as the core role and functions of the Consultative Board?

We agree with the statement expressed in the consultation that “the board’s key purpose...is...coordinating and facilitating delivery of strategic changes”.

The Consultative Board should be involved in undertaking the following activities:

- Industry Change Oversight & Prioritisation
- Reporting and Escalation
- Recommendations to Ofgem regarding Strategic Direction
- Providing change management expertise
- Holding code bodies to account on the delivery of change
- Evaluating any trades-offs or conflicts between strategic changes being undertaken
- Confirming that a strategic change is still desirable if a cost benefit analysis of suggests the net benefit has been overestimated or compromised.

We consider that the Change Overview Board and Project Nexus Steering Groups are examples of where an appropriate board/steering groups can assist in focussing the industry and facilitating the associated change programme.

Specifically, our experience of Project Nexus is that having a management oversight with the authority to bring industry parties together and prioritise a change process is helpful, and is particularly important when several industry participants need to implement changes to their internal systems or processes. The gas sector has a high degree of centralisation, however it may be the case that similar challenges of inter-party engagement and support are seen across both gas and electricity.

The consultation document appears to propose moving to this more robust and strategic board as an objective to be implemented over time. However, we would seek to avoid a circumstance where the role and function of the Consultative Board becomes an additional layer of bureaucracy, in sector that is already heavily administered. We have concerns that the Board, by virtue of being consultative only, may not have the appropriate vires to impose prioritisation or delivery decisions.

It is important to consider where the change management and project implementation expertise should reside. In the interest of reducing costs, and as it is not currently established in the code bodies, we suggest that it may be more efficient to have this expertise held by the Consultative Board.

We would also suggest consideration of the following:

- 1) How the costs of the Consultative Board should be shared across the industry particularly if the organisation has authority (which we would advocate);
- 2) How to ensure that it has effective representation across industry, management bodies, consumers and regulators;
- 3) How to ensure that Code Management bodies have the ability to control and regulate their workflows with appropriate checks in place being provided by the Consultative Board.

- 4) The composition of the Consultative Board and ensuring that representation is commensurate with industry arrangements and involves the relevant expertise. It must retain a focus upon consumer interests while also preserving the opportunity for industry parties to engage with the decisions to which they will be subject.

CHAPTER: Six: Moving to new arrangements

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

As suggested in the consultation document, the majority of existing projects should continue under their current governance, to ensure that delivery is achieved at the earliest point. However, we do consider that there are certain existing projects which may benefit from exposure to elements of the new arrangements. For example, as above, we consider that Faster Switching / Central Registration should be within the scope of the new arrangements and feel that a competitive tender for the already-licensed procurement activity could deliver efficiencies in cost and delivery versus that quoted by the incumbent organisation.

A second benefit of such an exercise would be in the early adoption of the new arrangements, thus achieving some of the intended benefits without suffering from any legislative delays.

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.

We consider that the enhanced powers will supersede the existing SCR powers, and we consider them to be an effective substitute. It is important to have a single process that is adhered to and appropriately empowered, rather than having multiple channels and instigators of change that dissolve strategic integrity.

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

We consider that a staggered approach will assist the industry in resourcing the competitive process, assimilating into the new arrangements and will also reduce any potential impact or disruption to the ongoing management of code activities. There are lessons to be learnt from previous and existing changes which involve multiple impacted parties, and we would wish to see these taken into account when planning the implementation of the new arrangements.

It will be important to ensure that the staggered approach is taken into account when considering the Strategic Direction and the associated Joint Industry Plan.

Should you require any further information with regards to our response then please do not hesitate to contact me at David.Handley@SGN.co.uk.

Yours sincerely,

David Handley
Head of Regulation
SGN