



3rd Floor North  
200 Aldersgate Street  
London EC1A 4HD  
Tel: 03000 231 231  
[citizensadvice.org.uk](http://citizensadvice.org.uk)

Laura Nell  
Ofgem  
9 Millbank  
London SW1P 3GE

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Dear Laura

## **Response to consultation on Industry Codes Governance**

Thank you for the opportunity to respond to your final proposals for Industry Codes Governance. Citizens Advice has a statutory duty to represent the interests of energy consumers in Great Britain. Citizens Advice is the consumer representative in the industry code governance framework. We have membership and voting rights on a number of the modification panels and can raise modifications on most codes. We are one of the few organisations to have a holistic view of codes. As we work in the interests of consumers as set out by our statutory functions we have no vested interest in the outcomes of codes processes. This submission is non-confidential and may be published on your website.

Overall, we support Ofgem's aim to better facilitate strategic change. In our view the codes governance framework needs fundamental reform if it is to be truly fit for purpose in a more dynamic and decentralised energy market. There are clear benefits to the proposals in the consultation. The current codes landscape is complex, and there is an opportunity to simplify this and address the underlying reasons for complexity. Doing so would make the codes process less burdensome for market participants, something that would be very welcome to the increasing diversity and number of market players.

At present, for the vast majority of proposals, the modification process is industry-led. This reflects the priorities of the relatively limited number of market

participants that have sufficient resources to engage with what can be cumbersome, complex and time-consuming arrangements. These modification processes can work well for making incremental improvements to the arrangements in a single code, particularly where these relate to the refinement of existing provisions rather than the introduction of major new concepts. But they are inflexible in catering for profound, strategic changes in direction. In our view, this is most pronounced where either the materiality and distributional impact of such changes is such that some parties have a vested interest in ensuring reforms do not successfully make it through the industry-led process. This was the case with locational losses. Similarly this occurs where party interests and consumer interests may not clearly align, as appeared to be the case with cash-out reform.

Previous reforms have incrementally improved codes governance - but these packages have not gone far enough. The introduction of the Significant Code Review (SCR) process by Ofgem in 2010 was an attempt to provide a vehicle for the regulator to step in and take such issues forward but, while in itself an incremental improvement on previous arrangements, does not appear to have provided enough of a systemic solution to allow Ofgem to tackle the major systemic challenges that the sector faces. The SCR process has proven cumbersome, with significant lag times between the initiation of reviews and the implementation of change. It also appears to us to be often inefficient, with issues that appeared to have been considered and resolved during the Ofgem-led part of the process being reopened again in the subsequent industry-led part of the process.

With regard to licensing, code administration is already technically a licensable activity as all of the code administrators are owned by licensees who are subject to both generic licence obligations (for example in relation to efficiency) and to specific ones in relation to the content and form of codes. But this existing licensing regime is indirect, and may not work well where the licensee has established an arms length relationship with the code administrator it appoints. For example, while the licence obligations in relation to the Balancing and Settlement Code sit within National Grid's licence. Its code administrator Elexon is functionally independent and not directly controlled by National Grid. It may also not work well where a code administrator is owned by multiple licensees, such as is the case with the Joint Office of Gas Transporters. For example taking collective enforcement action is likely to be even more difficult than taking enforcement action against individual licensees. Making code administrators directly licensable, and subject to performance incentives through those licences, should improve Ofgem's ability to ensure they perform to a high standard.

We note that there are already a range of licence powers allowing Ofgem to step in and try to tackle procedural failings in the ongoing development of a modification proposal. Ofgem has significant pre-existing powers to exercise quality control over modification processes.

Given this, although we support Ofgem having the power to licence, we think that each case should be considered on its individual merits and a move to licensing only instigated where there is a demonstrable benefit. Licensing codes is not without risk, and this is a key time given the amount of important reforms with consumer benefit being channeled through the codes (such as faster switching, half hourly settlement). Following this consultation we would like to see Ofgem's set out clearly its views of the risk and benefits of licensing. We would also like to know more about the intended licence structure. At present this is not clear, for example the consultation makes the comparison with the licensing of OFTOs. But management of a transmission asset is a very different regulatory arrangement to the management of an industry code.

Considerations around timescales and sequencing are important. Even on fastest timeline licensing of first code is unlikely to make a significant impact on smart roll out, faster switching, settlement reform as these will already be well underway. It is vital that non-licensing areas of reform are maximised and current powers used to fullest extent in order to drive through these strategically important reforms at a key time for the market.

## **CHAPTER: Two:**

**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?**

Yes we agree with the scope identified.

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

We think group 5 should be brought within the scope of the reforms as the codes and systems in this group play an important strategic role, but agree that group 3 should not.

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

Not answered.

## **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?**

We question whether this is always appropriate for all codes. Rather than impose a uniform model, we encourage Ofgem to consider arrangements for each code on a case by case basis.

### **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?**

We would welcome more detail on what this strengthening would be. Could see advantages and disadvantages on both sides. National Grid already has a licence that should compel it to make progress in many cases. But there are issues under the current arrangements. For example there is currently an impasse over CMP250 because the analysis required to progress the modification has not been carried out. This is despite National Grid already having a licence obligation to keep charging under constant review and on a cost reflective basis.

In some cases licensing could lead to consolidation which may give greater returns given the synergies in codes (eg between BSC & CUSC.) Such consolidation resulting in simplification would be a benefit in itself. It is paradoxical that a privatised industry should have such a complex bureaucracy at its heart. Complexity is not just a barrier to timely change but increases the day-to-day compliance burden of smaller players and new entrants who may not have the resource to dedicate staff to code governance.

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

We are unsure whether the permissive licence would be an efficient method. A generic licence is unlikely to demonstrate the capability to deliver any specific service which would have to be formally tendered for at a later point. In our view this favours sole provider licenses being more appropriate and less costly to all parties than a permissive approach.

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

We support a model that allows alignment with consumer objectives. But it does not flow necessarily that this has to be the option with lowest barriers to entry as there are a number of established players in energy and other utilities. The key will be ensuring the tender process is able to attract the widest range of bidders with the sufficient credentials.

## **CHAPTER: Four: Strategic direction**

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

Yes. We think it is essential that the purpose is to align codes with Ofgem's focus on consumer issues. We have argued in this in previous code reform packages. We think this should provide a vehicle to drive forward strategic changes in the sector by allowing the regulator to establish a roadmap for where it wants to get to, and by pressing the the code administrators to develop the route plan to get it there.

We agree it should provide the industry a steer regarding expectations for EU level and wider changes in the market. We agree it should be important in setting the scope of the work carried out by the consultative board, and should be an important factor in determining the tasks and responsibilities of parties in the new regulatory regime. Currently codes are driven by different objectives and Ofgem has its own criteria for assessing change. It may be that this drives some inconsistency in assessment/outcomes between codes.

We think it would be hugely beneficial if the strategic direction contained a consumer impact objective that both the working groups and code panels would assess changes against.

The introduction of a consumer objective as part of the strategic direction could facilitate engagement with the codes by a wider range of stakeholders through making the codes more accessible and relevant. The introduction of consumer impacts assessment as a result of CGR3 has been welcome, but we think this could go further.

Citizens Advice is currently usually the only consumer representative to meaningfully engage with industry codes processes. Other consumer groups do not attend code panels, and rarely provide consultation responses or attend working groups. Based on the feedback we receive from other consumer groups and interested third parties we perceive the barriers to be driven by lack of resourcing and the unintelligibility of both the codes themselves and their change processes to a casual user. It should not have to be this hard.

A consumer objective could help to draw out a plainer English explanation of why rule changes matter, and help to facilitate engagement with the end users who will have to pay for, and see the service they receive or costs/benefits they face, change as a result of them. It could also help to ensure that modifications are more robustly assessed before they are delivered to Ofgem for decision by encouraging more demand-side participation in the assessment process.

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

We think the strategic direction should be consulted on, and this seek input from a genuinely wide range of stakeholders including consumer groups. It should be reviewed on a regular basis, and in our view this should be done annually.

We agree that code managers and delivery bodies will need to work with the consultative board to develop a joint industry plan to deliver the strategic direction and prioritise their code modifications accordingly to ensure the timely delivery of strategic code changes. We agree that code panels will need to understand and challenge how code modifications being proposed are aligned with the strategic direction.

We agree that code parties raising code modifications will need to highlight to code managers the modifications they consider to be linked to the priorities set out in the strategic direction. However, it will also be important that the business as usual functions of the codes (issues affecting single codes, procedural issues) continue to be effectively dealt with and are not excluded because of the strategic direction.

We would be keen for the strategic direction to be operational as soon as possible. Whereas we see the benefit in developing a draft which is kept under review, if it has less formal traction in the first year (because it is voluntary) this runs the risk of delaying the benefits of a holistic and strategically aligned approach.

When implementing the strategic direction Ofgem need to consider the role of alternates to modification proposals which can be a significant barrier in some cases. These are not consistent between codes. For example in BSC one alternate can be raised but in CUSC many can be raised. In recent discussions on embedded benefits (CMP 264) there were 40 alternates raised, with a modification report reaching over 1000 pages. This was a considerable hurdle which hindered the decision making process.

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

We agree that the strategic direction should include:

- key outcomes which we are aiming to deliver through the code changes,
- a 'vision' of cross-code reform and an explanation of the key drivers,
- an explanation of which projects are strategic priorities for Ofgem and BEIS,
- an outline of the roles, responsibilities and accountabilities of stakeholders for delivering the strategic direction.

We agree that these should be mapped out at high level and that the industry should be responsible for mapping out a detailed plan. This is in line with the broader move to principle based regulation. A balance will need to be struck to avoid being too prescriptive, and ensuring that the impact of the strategic direction does not get dissipated by multiple interpretations.

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

The key projects for the initial strategic direction are:

- Faster switching
- Project Nexus
- Half hourly settlement
- Smart meter roll out
- Flexibility/demand side response

Looking forward, it will be important for the strategic direction are those projects which carry specific and tangible consumer benefits but which don't fully align with industry incentives, or where industry incentives conflict.

## **CHAPTER: Five: Consultative board**

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

We agree that the core issue at stake is the pace of delivery of cross-code changes that benefit consumers. This needs to be faster. Incentives for change play a key role in this. In some cases, there is a lack of incentives under the current system for industry to engage in the change process.

We agree that the current system is not setup to facilitate delivery of change that benefits consumers. The structure needs to change to support better

coordination of change across codes, with code managers and delivery bodies accountable not only to their shareholders but also to the wider public interest

CMA's recommendation that Ofgem set up and run a standing forum (the 'consultative board') to bring stakeholders together to discuss and address cross cutting code issues. It intended it to be a body that would coordinate cross-code changes linked to the development and delivery of Ofgem's strategic direction. We think Citizens Advice could play a key role on the board.

We agree with the core role key purpose as coordinating and facilitating delivery of strategic changes across codes However , it is not clear on the way the consultative board will interact with existing codes' governance or their roles and responsibilities.

We question, given its intended scope and responsibilities whether consultative board appears to be the wrong title. It would be better to call it a steering board, or delivery board. This would better reflect its role and responsibilities.

Depending on the size and the makeup of the board there is an opportunity to consider using the consultative board to increase representation from consumer groups, and from smaller and newer market entrants. Certainly bringing the views of these stakeholders in at a strategic level should be an objective of the board.

We think there would be significant value in allowing the board to consider modifications with a cross-code dimension. This would have greatly helped when considering past proposals to introduce half hourly settlement that necessitated changes to multiple codes (Balancing and Settlement Code ('BSC') and Distribution Connection and Use of System Agreement) that made sense in combination but did not make sense in isolation. That fragmentation was a causal factor of the BSC Panel recommending rejection of P272, causing knock-on delays to its implementation. Similarly, it would be useful to amend the industry code objectives to enable code panels to recommend implementing a proposed amendment to a code where, in combination with changes to other codes, it would deliver consumer benefits. At present, they are precluded from making assumptions that contingent changes will take place - again, this was a constraint on P272, where the BSC Panel did not consider that it was allowed to assume that distribution charging rules needed to make that modification work would be brought in, as those changes were outside its remit.

Codes are increasingly considering modifications that deal with a wider range of actors, such as P315 and P321. Ensuring that change processes engage

**Patron HRH The Princess Royal**      **Chief Executive Gillian Guy**

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Registered office: 3rd Floor North, 200 Aldersgate Street, London EC1A 4HD

effectively with all these actors is crucial for the legitimacy of the solutions that are ultimately submitted to Ofgem.

## **CHAPTER: Six: Moving to new arrangements**

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

We think it is important that ongoing projects and business as usual are not disrupted by the new codes arrangements. In the long term the new arrangements should better facilitate these projects. However it is important in the short term to ensure that any changes to introduce new processes or licensing do not have negative impacts.

### **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.**

No - Ofgem will need to retain these powers for a significant period of time. We note that even at a rate of 4 licenced codes per year, if full number of codes were eventually covered this would take the best part of 3 years. On the quickest time path the legislation would permit the first process to begin in 2019, this would mean Ofgem's SCR powers remain important until at least 2022 as Ofgem will need to retain these powers to drive strategic change in the interceding time.

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

This is sensible given that many of the same parties are likely to be involved. It is important that any competitive process delivers the maximum benefits for consumers.