

To all interested stakeholders

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Dear Colleagues,

Update on the implementation of the CMA Code Governance Remedies

We published the Industry Code Governance: Initial consultation on implementing the Competition and Markets Authority's recommendations on 9 November 2016.¹ Our consultation closed on 1 February 2017. The purpose of this letter is to provide an overview of the responses to this consultation and an update on our next steps.

Background

The Competition and Markets Authority (CMA) recommended a package of remedies for code governance to support a coherent vision for strategic industry change led by Ofgem, and clearer accountabilities for delivering it by the industry. We agree with the CMA that the current arrangements have a negative impact on consumers' interests and competition. We believe that key changes must be put in place to ensure that the system is able to handle the growing need for coordinated code change.

In our consultation document, we outlined our initial views on what the scope of the new regulatory framework should be and how we should transition to it. We also set out our initial proposals for our strategic direction for codes, the consultative board and the licensing of code managers.

We held a workshop on 12 January 2017, with presentations by stakeholders and working sessions on the strategic direction, the modifications process and the consultative board.² Sixty five stakeholder representatives signed up to attend the workshop. We had positive and constructive engagement from stakeholders on the key elements of the package. Attendees put forward some constructive ideas on alternative options to licensing and on different ways the consultative board could operate.

Summary of responses

We received 41 responses to the consultation.³ We have not received any confidential responses. The views expressed by respondents are summarised below. A more detailed

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

² <https://www.ofgem.gov.uk/publications-and-updates/stakeholder-event-initial-consultation-implementation-cmas-code-governance-remedies>

³ Annex 2 contains the list of respondents. The responses to the consultation 'Industry Code Governance: Initial consultation on implementing the Competition and Markets Authority's recommendations' are published on the Ofgem website: <https://www.ofgem.gov.uk/publications-and-updates/industry-code-governance-initial-consultation-implementing-competition-and-markets-authority-s-recommendations>.

summary of the responses by consultation questions is available in Annex 1. We grouped the respondents' views according to the issues covered by our consultation document: scope of the new arrangements, licensing and competition, strategic direction, consultative board, and moving to the new arrangements.

Scope of the new arrangements

In our consultation, we suggested that the Code Administration Code of Practice (CACoP) codes⁴ and the central system delivery functions⁵ should be included in the new arrangements and asked whether stakeholders think the scope should be broader or narrower.

The majority of the respondents agreed with the codes and functions we identified. Some suggested that all codes (including upcoming ones) could be within scope. Others suggested that the Data Transfer Service (DTS) and the Security and Quality of Supply Standard (SQSS) could be included as well.

Licensing and Competition

Licensing

Our consultation set out possible approaches to licensing code managers and delivery bodies. We sought views on our proposals to include the code manager and delivery body function in a single licence and strengthening the licence of National Grid Electricity Transmission (NGET) to include new code management requirements.

The majority of the respondents did not support licensing for a range of reasons, including:

- Concerns with accountability and whether a code manager could be responsible for the actions of code parties, whose actions would not be within their direct control.
- The benefits of licensing had not been evidenced, and these would need to be weighed against the increased regulatory burden and other costs.
- A one size fits all approach should not be used across the board. What works well, and the value current code administrators provide, should not be negatively impacted by the changes.

However, most respondents were supportive on the specific question of including a code manager and delivery body in a single licence, as long as it is done on a case-by-case basis to take into consideration existing business models. Those that were against the proposal gave similar reasons to those provided for not supporting licensing in general, with additional concerns in relation to the consistency with current industry governance arrangements and disruption to existing organisations. Respondents were fairly evenly split regarding whether or not to strengthen NGET's licence.

Competition

We identified four licensing models based on whether licensing precedes or follows tendering, and whether tendering is carried out by Ofgem or another body. We acknowledged that the models have different strengths and weaknesses and may be better suited to some codes than others.

Some respondents questioned the benefits case for competitive tendering and raised risks associated with retaining the level of expertise required, knowledge transfer, the sharing of good practice and underinvestment. Most respondents said they preferred Ofgem running the tenders and then providing licences to the winners (model 3). Few respondents expressed their opinion on which model may be appropriate for different codes, or types of

⁴ The NETSO codes (CUSC, GC, STC) and the non-NETSO codes (BSC, MRA, DCUSA, DC, SEC, UNC, SPAA, iGTUNC).

⁵ These are the Smart metering, Gas and Electricity central systems delivery functions.

codes, but the majority of those who did, preferred consistency with regards to the tendering procedure used across different codes.

Strategic direction

In the consultation document, we proposed that the strategic direction would set out what outcomes Ofgem is aiming to achieve through changes to industry codes. Accordingly, we proposed that the strategic direction should contain the key outcomes to be delivered, the roles and responsibilities in relation to it, a 'vision' of cross-code reform, and an explanation of our priorities. We also outlined a list of activities and projects to be included in the strategic direction. Lastly, we proposed a three stage development plan for the strategic direction: firstly, establishing the content and the level of detail required, then defining the responsibilities, and lastly, designing how stakeholders are made accountable for delivering in line with the strategic direction and incentivised to drive strategic change.

We asked stakeholders whether they agreed with the purpose of the strategic direction and for their views on how to develop and implement it. We also asked for their views on which Ofgem projects should be included in the strategic direction and how much detail on these projects would be appropriate.

Respondents expressed wide support for the strategic direction while flagging that it should be consulted upon. They emphasised the importance of the delivery framework, to ensure that stakeholders are accountable for delivering the outcomes set out by Ofgem in the strategic direction, which underlines the synergy between the strategic direction, the consultative board and licensing. Most respondents agreed with the projects we suggested we would include in the strategic direction, while a few recommended including other projects too.⁶ It was also suggested that longer term Ofgem projects (5+ years) should be included, at least at a high level. In terms of the level of detail required on the projects in the strategic direction, stakeholders expressed a need for balance. Ofgem should be clear on what is needed without being too prescriptive; essentially we should state what needs to be achieved but not how.

Consultative board

We proposed that the board's key purpose should be coordinating and facilitating delivery of strategic changes across codes and enabling the delivery of the strategic direction by translating this into a joint industry plan. We suggested that the consultative board should be capable of making non-binding recommendations to the Authority. Also, market participants, code panels, code managers and delivery bodies should have an obligation to provide information to the board.

We asked stakeholders what they see as the core role and functions of the consultative board.

Stakeholders generally supported the creation of the consultative board and agreed that it should develop and maintain a joint industry plan. They suggested that a secretariat might be needed and that it would need to have powers to operate effectively. Stakeholders proposed that the consultative board could prioritise modifications, although they also pointed out that this would interfere with the status quo and might not be effective unless the board had powers to direct changes. It was suggested that the consultative board could proactively seek to spot gaps and overlaps in the code managers' tasks. Respondents also flagged that the composition and funding of the consultative board were major issues to be decided upon.

Moving to new arrangements

We set out our view that the proposed reforms are unlikely to affect the governance of major projects and programmes (eg switching programme, half-hourly settlement) and that

⁶ Additional projects suggested by respondents includes: Security of Supply, ECO reform, Priority Services Register and Extending Competition in Electricity Transmission.

our Significant Code Review (SCR) powers are unlikely to be required once the full package of remedies is in place. We also outlined some pros and cons for a staggered approach to running competitive applications.

We asked stakeholders to submit their views on how moving to the new arrangements would impact existing projects, and on staggering the implementation of competitive applications for licences. We also asked whether they thought our SCR powers will be obsolete once the new arrangements are operational.

The main concern expressed by stakeholders was that the code governance system is already stretched; moving to the new system would add work and lead to delays with current projects. The majority of the respondents who provided a view on staggering were in favour of it. Stakeholders' opinions were fairly evenly divided on whether Significant Code Review powers would remain necessary.

Ofgem's views

We welcome the general support received for the strategic direction. As we develop our proposals further, we will consider the suggestions for additional projects and reflect the developments in our recent Forward Work Programme for 2017/8⁷ and any further developments in our upcoming Forward Work Programme. We acknowledge the need for appropriate consultation on the content of the strategic direction. We will consider how best to achieve this reflecting that certain projects or priorities set out in the direction will have been the subject of consultation with industry elsewhere, and that they ought not to be reopened through any consultation on the direction. We will also consider how the process of developing and updating the direction fits with our existing Forward Work Plan process.

We agree with respondents' views that once the strategic direction is developed it will be important that it is supported by the appropriate delivery mechanism. The industry and the consultative board will play an integral part in this. Although generally supported, we need to do additional work on the consultative board to assess its functions, composition and resourcing.

Our overriding objective for these remedies is to achieve greater coordination across codes and deliver strategic change that benefits consumers and competition quickly. We will be focussing on developing and implementing our strategic direction for codes and setting up the consultative board to help us deliver it. Although we see the programme of work for the licensing arrangements as an important component to deliver our objective, licensing will not be possible without primary legislation. Until the Government brings forward legislation, we will be prioritising the other work streams.

We remain concerned that the current role of code administrators will not be adequate to enable future industry change to be implemented in the interest of consumers. We see value in working collaboratively with industry stakeholders to embed the strategic direction and consultative board. We can see benefits in trialling the measures before making framework changes, be that through existing codes and licences or future legislation.

Closely related to potential trialling of measures, we continue to see benefits in the parallel work code administrators are already leading on, seeking to fully implement the findings of the latest phase of our own code governance review, which concluded last year ('CGR3').⁸ The changes identified under CGR3 are making important incremental improvements while the reform to deliver the CMA's remedies is developed and implemented. We believe the changes identified under that review are an important step towards the more fundamental changes that we are seeking to deliver with the CMA remedies. We strongly urge Panels and the wider industry to work closely with their code administrators, to implement and embed the range of measures, such as individual and cross code forward work plans. These are aimed at improving joint working and coordination based on the existing industry code

⁷ https://www.ofgem.gov.uk/system/files/docs/2017/03/ofgem_forward_work_programme_2017-18.pdf

⁸ https://www.ofgem.gov.uk/system/files/docs/2016/03/code_governance_review_phase_3_final_proposals_2.pdf

governance arrangements, and are in the direction of travel of the broader reform the remedies are seeking to deliver.

Next steps

We will organise a workshop to discuss the strategic direction and the consultative board in the autumn as well as continue to engage with existing stakeholder forums as policy thinking develops. We will consult further on the strategic direction and the consultative board in late 2017. We plan to have the strategic direction and the consultative board in place by spring 2018.

Milestones	Timing
Workshop on the strategic direction and consultative board	Q4 2017
Consult on the strategic direction	Q4 2017
Strategic direction in place	Q1/2 2018
Consultative board operational	Q1/2 2018

If you have any questions about the issues outlined in this letter, please contact Dr. Győző Pintér at (gyozo.pinter@ofgem.gov.uk).

Yours faithfully,

Laura Nell
Head of Code Governance Reform
Consumers and Competition

Annex 1: Summary of responses

Chapter 2: Scope of the new arrangements

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?

The vast majority of respondents who answered this question agreed that the codes and functions we identified should be within the scope of the new regime. Four respondents disagreed with our suggestion, mostly because they believed that the scope of the reforms should be expanded to include elements of the modifications process itself, and that it should be confined to codes that support central systems, since widening the scope would put more pressure on the already congested code governance system.

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

Although the vast majority of respondents that answered this question agreed with our proposals, a number of respondents indicated that other codes should be considered to be included in the new regime. For purposes of consistency, harmonisation, strategic function played by the code and/or its impact on consumers and market, respondents most commonly suggested the inclusion of all codes (including upcoming ones), while a few suggested adding only the Data Transfer Service (DTS) or the System, Security and Quality of Supply Standards (SQSS).

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

The factors most quoted by respondents were:

- costs for the industry (especially how code managers will be funded)
- impact the code will have on consumers
- alignment with the Faster Switching and Xoserve's Funding, Governance and Ownership (FGO) programmes
- future direction of travel of each code
- independence of National Grid's system operator's business and its impact on NETSO codes
- keeping economic and innovative delivery of code administration
- clarifying the decision-making role between code panels and code managers
- selecting codes by modification history (including modifications arising out of Significant Code Reviews) where this shows that parallel modification of multiple codes has been necessary to achieve reforms and
- organisational relationship between Xoserve and the Joint Office.

Chapter 3: Licensing and competition

Support for licensing

The majority of respondents did not support licensing code managers, the main reasons provided were:

- concerns with accountability, that a code manager could be penalised for actions of code party
- increased regulatory burden
- high cost with no proven benefits and
- the consolidation and loss of knowledge by frequent appointments.

Respondents proposed strengthening the CACoP, or entering into a service agreement or Memorandum of Understanding (MOU) with the parties instead, as an alternative to licensing.

Some respondents showed support for licensing, on condition that it is done on a case-by-case basis with demonstrable benefit.

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

Most respondents supported our proposal, but argued that this must be done on a case-by-case basis, and would need to take into consideration individual business models, particularly to avoid any conflicts of interest. Respondents highlighted that not all companies could deliver both the code manager and delivery activities, which could restrict those who feel able to participate in a competitive tender compared to tendering for the functions separately.

A number of respondents were sceptical about bundling the two activities, including the majority of the large suppliers. The main reasons provided for this are detailed below.

- There is no clear benefits case.
- It is difficult to define the prohibited activity.
- The proposals are inconsistent with the implementation of the funding, governance and ownership review (FGO), and may have the undesired effect of negating the innovation introduced under the review.
- The code modification process may take too long once the new system is operational.
- Changes in current employment arrangements should be considered and the added complexity and time for organisational changes needs to be factored in. For example, under the UNC where a single licence will mean bringing people from different organisations together under a single body would be a significant change to employment arrangements.
- There are concerns over accountability, including ensuring there is a clear line of accountability and management between code administration and system operation services, and also that those parties who are frustrating strategic change are held to account. It would be unfair if code managers were penalised for actions outside of their direct control.
- There are a number of concerns related to conflict of interests. One respondent felt the proposal would further exacerbate the influence incumbents currently have. Another is concerned with how a combined Code Administrator and Delivery Body would be able to appropriately manage its competing interests under the codes. There is a preference for the new licensing arrangements to not perpetuate existing licensees holding code administration responsibilities. One respondent emphasised that the principle of separation should be applied to the new licensing arrangement to avoid conflicts of interest.

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?

There was no dominant view on the issue. A little over half of the respondents opposed the proposal, mostly based on calls for a consistent approach between codes and concerns regarding potential conflicts of interest. However, almost as many stakeholders agreed with our proposal, claiming that it would minimise cost and disruption and ensure continuation of expertise, but that it might also deter innovation and that competition may reduce the costs of NGET activities. Some respondents said that strengthening the licences should go hand in hand with adding safeguards preventing potential conflicts of interest.

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

A number of respondents questioned the benefits case for competitive tendering. Others were concerned with the risks that competitive tendering could bring. These included retaining the level of expertise required, knowledge transfer, the sharing of good practice and underinvestment. One respondent supported competition in this area, saying that it will deliver the best suited and low cost solution for industry change management. Respondents sought clarification on how the costs would be funded. One respondent thought that a movement to full competition should only be considered if an impact assessment identified there would be benefits.

The majority of respondents preferred model 3 (Ofgem running the tenders then providing licences to the preferred bidder) if we went ahead with licensing, arguing that Ofgem is independent and trusted by the industry. They also claimed that this is a more transparent, appropriate (mostly for larger codes) and less costly model, than the others, and that licences were easier to both modify and enforce than contracts.

Some respondents suggested that model 2 (Ofgem grants licences to applicant then another body runs tenders) was suitable for smaller codes. It was highlighted that both industry and code panels must have an input in the procurement procedures, or code panels should run the procedures, as they have more expertise and ultimately pay for the services.

The permissive model was criticised, mostly because respondents thought it would not be enforceable, the 2-step qualification process was too low hurdle and resource-intensive for Ofgem and there was unlikely to be enough competition for this type of service. It was also mentioned that this model would be inefficient, as it would create a large pool of candidates with unused licences that would have to be re-evaluated by the time the licence is re-tendered.

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

Few respondents commented on the process. Responses were polarised; either in favour of consistency between all codes, that is, the same model should be applicable for all codes, or the opposite (different codes require different models). The majority favoured consistency.

Chapter 4: Strategic direction

Do you agree with the purpose of the strategic direction?

There was wide support for the strategic direction, some stakeholders even asked for its early introduction. A minority of the respondents had reservations about it; one expressed support only on the condition that the strategic direction would be largely consulted upon and some suggested that the strategic direction should be BEIS' remit.

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

In terms of the development of the strategic direction, the need for consulting and taking on board a wide range of initiatives was emphasised; from the inclusion of industry projects, since those might carry strong consumer benefit too, to making sure consumer bodies have a say.

Regarding the implementation of the strategic direction, the necessity of a governance framework came across as a strong message.

There were suggestions to translate BEIS' Strategy and Policy Statement into appropriate signals for the industry and also to link the strategic direction to the Forward Programme, or even develop the latter two together.

Stakeholders also suggested synchronising the codes' and Ofgem's objectives for greater consistency, as well as adding a consumer objective.

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

It was suggested that we should be clear on what is needed without being too prescriptive; essentially we should say what needs to be achieved but not how.

Respondents also said that the roles and responsibilities regarding the delivery of the strategic direction should be described in the document. A timeline of projects with key milestones was also deemed necessary.

Some respondent suggested that the time-frame should cover 5+ years, although they said that long term plans can be less detailed than short term ones.

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

Respondents generally agreed with the content we suggested in the consultation document, while some said Ofgem might want to consider adding the Security of Supply, the Energy Company Obligation (ECO) reform, Priority Services Register, and the Extending Competition in Electricity Transmission projects.

Chapter 5: Consultative board

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

Stakeholders generally supported the creation of a consultative board, and agreed with the functions we identified, including it being responsible for the development and maintenance of a joint industry plan. One stakeholder rejected the creation of a consultative board, suggesting consolidation in the form of a single code administrator instead.

A number of respondents suggested that the consultative board should have a secretariat to be able to carry out its tasks adequately. Also, the need for powers was emphasised so the consultative board could work effectively.

It was clear from the responses that the composition of the consultative board was an important area of work. Funding arrangements and making sure the consultative board delivers value for money were also mentioned as crucial issues.

Respondents sought more clarity on the role of the consultative board and on interaction with other stakeholders, flagging that work should not be duplicated and that the consultative board should not add to the complexity to the industry without good reason.

Regarding its functions, respondents mentioned that the consultative board should proactively seek to spot gaps/overlaps, in cases this was not obvious.

Another issue flagged was that prioritisation would be difficult, therefore some stakeholders suggested that the strategic direction should provide good guidance, and powers would be needed for the consultative board to be effective in this respect.

Some respondents also highlighted the need for awareness to handle electricity and gas together or separately, based on what works best in light of the synergies and differences between the two fuels.

Chapter 6: Moving to new arrangements

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

There was a strong view that actors of the current system are already running on full capacity and struggle to keep up with the changes necessary. The proposed new arrangement might lead to delays with current projects, because they would have to allocate some of the workforce to deal with tendering, stretching their aptitude even further. Another respondent pointed out the effect on contracts, namely that the break point is unlikely to coincide with our plans.

Some respondents mentioned positive effects, such as that:

- it would be helpful in the long-run so the challenge is to minimise short-term detriment
- the strategic direction and the consultative board in itself is helpful
- switching and Half Hourly Settlement would benefit from coordinated delivery and
- it would lead to more Ofgem influence.

One respondent said that moving to the new arrangements would have no impact on existing projects and another that it would have limited effect on the Distribution Connection and Use of System Agreement (DCUSA) projects.

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.

There were diverging views on whether SCR powers would still be necessary in the new system, even within stakeholder groups. One suggestion was to test the new system and see whether Ofgem have the influence in practice that makes the SCR powers unnecessary.

One respondent estimated that the SCR should be retained until at least 2022 given the realistic pace the new arrangements would come into effect.

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

Many respondents said that they did not support licensing in general, and provided no view on staggering per se. Those who expressed a view on staggering were overwhelmingly in support of it. One respondent said that if licences would be different for each code, it might be best to stagger, otherwise it might be better to do a single tendering exercise. Another respondent called for the path to the new system to be as short as possible.

We received a few alternative suggestions, for example to test the system first on a stand-alone code and to licence incumbents first, so that benchmarking could be carried out before starting competition.

Other issues

Some respondents expressed views on code governance matters that were beyond the scope of our consultation:

- Some stakeholders suggested that we set up a single code body instead of creating several code managers.
- There were calls for reforming the codes themselves, such as consolidating codes or at least some of them, aligning code objectives and unifying the modification process across the codes.
- Some respondents raised issues around the differences in the funding mechanisms for different code administrators.
- Some respondents provided examples of existing arrangements that could provide useful lessons learnt when designing the Consultative Board.

Annex 2: List of respondents

1. Botrodger Consulting
2. Bristol Energy
3. BSC Panel
4. Centrica
5. Citizens Advice
6. Cornwall
7. DCC
8. DCUSA
9. EDF
10. ElectraLink
11. Electricity North West
12. Elexon
13. ENA
14. Energy Systems Catapult
15. E.ON
16. First Utility
17. Flexible Generators Group
18. Good Energy
19. Grid Edge Policy
20. Institution of Engineering and Technology
21. Gemserv
22. Joint Office
23. Mike Toms
24. National Grid Gas Distribution Limited
25. National Grid
26. Northern Gas Networks
27. Northern Powergrid
28. Npower
29. Opus
30. Scotia Gas Networks
31. SEC Panel
32. SP Energy Networks
33. Smartest Energy
34. Solar Trade Association
35. UK Power Networks
36. SSE
37. Wales & West Utilities
38. Xoserve
39. Uniper
40. Energy UK
41. Scottish Power