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Action	For Decision

# Ofgem's Industry Code Governance Consultation

This paper has been prepared to inform the DCUSA Panel on the content of Ofgem's initial consultation on implementing the Competition and Markets Authority's recommendations on Industry Code Governance.

## 1. Background

- 1.1 On 24 June 2016, the CMA published its Final Report on the Great Britain energy market investigation which was first opened in June 2014 following Ofgem referral.
- 1.2 The Final Report details the CMA's package of 26 remedies which seek to '*revitalise the energy market*' and bring about technical and regulatory changes to '*intensify competition*' between energy companies and ensure the market works in consumers' interests. At a high level, the package has been designed to achieve four overarching aims:
  - Creating a framework for effective competition;
  - Helping customers to engage;
  - Protecting those who are unable to exploit the benefits of competition; and
  - Future-proofing the CMA remedies by building a robust regulatory framework.
- 1.3 This paper provides the DCUSA Panel with an overview of Ofgem's latest consultation in regards to implementing the CMA recommendations around Industry Code Governance which was published on 9 November 2016, with a deadline for responses by 1 February 2017.

## 2. Overview of Industry Code Governance Consultation

- 2.1 Ofgem's consultation published on 9 November 2016 is the first step in delivering the CMA recommendations surrounding Industry Code Governance. Within the consultation, Ofgem highlight that a large suite of industry codes and central systems currently exist which drive the day to day working of the industry. Currently bodies which are answerable to and funded by the industry run

the codes and associated central systems and that although this approach make sense for where small scale changes are required to the rules and systems, Ofgem states that significant industry change is on the horizon which calls the model into question.

- 2.2 The consultation highlights Ofgem’s views on what needs to change to current code governance arrangements. This includes expanding the role of code administrators to become code managers, through licencing. The licences will set clear requirements and incentives for code managers to deliver strategic change set by Ofgem under a coherent vision. The licences will be put in place through competitive tendering which Ofgem views will ensure value for money and a transition to improved cross-code consolidation.
- 2.3 In summary the key changes Ofgem plan to put in place to improve code governance arrangements are:
- **Licensing of code managers and delivery bodies:** Ofgem will design a new regulatory regime for code management and system delivery, considering a role for competition in driving benefits for consumers.
  - **Setting a strategic direction for code development:** Ofgem will introduce a new tool to provide industry with a coherent vision for change. This will set the parameters of the new arrangements, making sure effort and resources are focused on the industry changes that benefit customers most.
  - **Establishing and running a consultative board:** This new body will coordinate and prioritise cross-code change that benefits consumers. It will develop and help maintain a joint industry plan in line with the strategic direction.
- 2.4 In terms of next steps, Ofgem highlights it wishes to make sure the remedies are practical, workable and operate in consumers’ best interests and Ofgem will therefore consider fully a range of implementation options before the right approach is decided.

### 3. Summary of Consultation Proposals

- 3.1 The consultation is split into 5 key sections which Ofgem invite responses from industry parties through a series of questions (which are listed under Appendix 1 to this paper):
- Scope of the new arrangements;
  - Licensing and Competition;
  - Strategic Direction;
  - Consultative Board; and
  - Moving to new arrangements.

#### Scope of new arrangements:

- 3.2 The consultation divides industry codes and delivery bodies into five broad categories as follows:

*National Electricity Transmission System Operator				
1	2	3	4	5
NETSO* codes	Non-NETSO codes	Other codes, agreements and standards	Central System Delivery Functions	Wider delivery Functions
CUSC GC STC	BSC MRA DCUSA DC SEC UNC SPAA IGTUNC	All those currently outside the CACoP eg SQSS	System delivery of: SEC (DCC Service) UNC BSC	Other system delivery functions eg DTS

- 3.3 All the codes listed in Group 1 and 2 (in which DCUSA is included) are within the scope of CACoP and viewed by Ofgem to potentially play a material role in delivering strategic changes to the energy market and should therefore be considered within the scope of new arrangements.
- 3.4 Group 3 includes other codes, agreements and standards that are currently outside of CACoP, as such Ofgem does not see a strong case for bringing this group within the scope of new arrangements.
- 3.5 Group 4 includes any central system delivery functions, such as the delivery of SEC (smart metering central systems delivery), the UNC (gas central systems delivery) and the BSC (electricity central systems delivery). Ofgem considers that the three core delivery functions within the group should be considered as part of the scope of new arrangements.
- 3.6 Finally, Group 5 details wider delivery functions such as the DTS and Ofgem are open to whether the DTS or other delivery functions should be considered under the scope of new arrangements.

### Licensing and Competition

- 3.7 Section three of the consultation seeks views on Ofgem's proposed new arrangements regarding licensing and competition which include awarding code manager licences. This will expand the role of code administrators to include change management, code ownership and providing strategic direction across a wider framework. As a result of these changes there will need to be amendments made to code panel responsibilities and code manager responsibilities. Ofgem are considering consolidating codes where there are significant overlaps however large scale code consolidation remains outside the scope of this consultation.
- 3.8 Ofgem highlight that based on existing precedent in the energy sector, there are two possible approaches to awarding licences for the new roles:
- **Permissive licences:** A low bar pre-requisite to bidding for the role, which allow an organisation to carry out a relevant role, potentially subject to meeting certain requirements. This would allow for a pool of code managers to exist which can bid for the role of code management for a particular code.
  - **Sole provider licences:** A single licence per code, requiring the licensee to provide the relevant service. This is awarded as a result of the competitive licence application process.
- 3.9 Ofgem has also put forward four proposed models for licensing in order to promote competition, these include:
- **Model 1:** where Ofgem grants licences to applicants that demonstrate basic requirements then Ofgem runs a code tender to award specific licences;
  - **Model 2:** where Ofgem grants licences to applicants that demonstrate basic requirements then other bodies run tenders for individual contracts;
  - **Model 3:** Ofgem runs a tender to select a code manager; and
  - **Model 4:** another body runs a tender to select a code manager and Ofgem grants a licence to the winner.
- 3.10 We assume that Model 2 and Model 4 will be most akin to the current arrangements, with DCUSA Ltd presumably retaining the ability to run a competitive tender and select a preferred code manager. A summary of Ofgem's views of the pros and cons of each of the models is outlined below.

<p><b><u>Model 1</u></b></p> <p>Pros:</p> <ul style="list-style-type: none"> <li>• Low barrier of entry approach.</li> <li>• Maintains a pool of applicants for future work.</li> <li>• Process could be designed and staggered to enable future code manager (and delivery body) consolidation.</li> </ul> <p>Cons:</p> <ul style="list-style-type: none"> <li>• More complex, two-stage approach to achieve the same outcome as model 3.</li> </ul>	<p><b><u>Model 2</u></b></p> <p>Pros:</p> <ul style="list-style-type: none"> <li>• Maintain high industry involvement.</li> <li>• Potentially more proportionate for smaller codes, with less direct consumer impacts.</li> <li>• Low barrier of entry approach.</li> <li>• Maintains a pool of applicants for future work.</li> </ul> <p>Cons:</p> <ul style="list-style-type: none"> <li>• Difficulty in deciding who is best placed to run tender and what vested interests may be.</li> <li>• Incentives and requirements on panels (if running tender) may mean that the consumer interest is secondary.</li> <li>• May still be a role for Ofgem on tender design and implementation (though likely to be less than Model 4).</li> <li>• Service contracts may be less transparent than licences.</li> </ul>
<p><b><u>Model 3</u></b></p> <p>Pros:</p> <ul style="list-style-type: none"> <li>• Appears closest to addressing CMA's concerns.</li> <li>• All requirements in the licences initially so less complexity (compared to two-stage approach).</li> <li>• Process could be designed and staggered to enable future code manager (and delivery body) consolidation.</li> </ul> <p>Cons:</p> <ul style="list-style-type: none"> <li>• May be disproportionate for smaller codes with less direct consumer impacts.</li> </ul>	<p><b><u>Model 4</u></b></p> <p>Pros:</p> <ul style="list-style-type: none"> <li>• Maintain high industry involvement.</li> <li>• Potentially more proportionate for smaller codes, with less direct consumer impacts.</li> </ul> <p>Cons:</p> <ul style="list-style-type: none"> <li>• Difficulty in deciding who is best placed to run tender and what vested interests may be. Incentives and requirements on panels (if running tender) may mean that the consumer interest is secondary.</li> <li>• Still requires a significant role for Ofgem on tender design and implementation (via the granting of a licence), so may not allow for level of delegation to industry which Model 2 would allow.</li> </ul>

## Strategic Direction

- 3.11 Within Section 4 of the consultation, Ofgem outlines its initial views for developing a strategic direction for codes including what the strategic direction could contain, how it could be developed, implemented and maintained.
- 3.12 In summary, the strategic direction may contain the following areas which Ofgem view would help ensure resources are used efficiently and code modifications to be prioritised effectively:
- key outcomes which Ofgem 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; and
  - an outline of the roles, responsibilities and accountabilities of stakeholders for delivering the strategic direction.
- 3.13 Ofgem further outline that they believe there are three stages to developing a strategic direction and invite industry respondents' comments on the staged approach:
- develop what it should contain and the level of detail required;
  - define which stakeholders (including Ofgem) are responsible for which activities to deliver strategic change and developing a process to ensure it remains relevant (including the role of the consultative board); and
  - design how stakeholders are made accountable for delivering in line with the strategic direction and incentivised to drive strategic change.

- 3.14 Ofgem intend to work with stakeholders to develop a draft of the strategic direction by late 2017. Once the consultative board is operational next year, it is understood that Ofgem will work with it to develop the joint industry plan required to deliver the strategic direction.

#### Consultative Board

- 3.15 The CMA recommended that Ofgem set up and run a standing forum (which will act in an advisory capacity) to bring stakeholders together to discuss and address cross cutting code issues, as such Ofgem's consultation under section 5 provides detail into why a consultative board is needed and its purpose/role.
- 3.16 Ofgem confirm it intends to implement a consultative board in 2018, a summary of Ofgem's views into the Consultative Boards key functions is detailed below:
- Inform the content of the strategic direction and assist Ofgem with the coordination of cross-code changes, including the strategic direction;
  - Develop and maintain a joint industry cross code change plan to facilitate delivery of the strategic direction and ensure consistency across codes;
  - Perform an assurance role for delivery of the strategic direction/ joint industry plan;
  - Provide a mechanism to improve Ofgem's understanding of the substantive scope of the code regime;
  - Perform a risk management/ risk mitigation role;
  - Make non-binding recommendations to Ofgem on strategic code development, which we can decide whether to accept;
  - Facilitate engagement between the industry, Ofgem, code panels, code parties, code managers and delivery bodies; and
  - Share best practice, learning and experience.
- 3.17 Ofgem is to run follow up stakeholder workshops next spring on the board's composition, terms of reference, funding and appointments process to allow the board to be up and running in early 2018 following the publication of a draft strategic direction.

#### Moving to new arrangements

- 3.18 In order to minimise the effect of moving the proposed new arrangements, section 6 of the consultation outlines Ofgem's understanding of the impacts the new arrangements would have on existing and upcoming projects<sup>1</sup> and how implementing the new arrangements can be managed, such as staggering implementing the new competitive licences. Ofgem call for industry participants to put forward views on how many licences or contract tenders should be ran each year, in what order, and how frequent the re-competition of the positions should be (such as 3-6 years).
- 3.19 During the consultation section, Ofgem also call for responses on whether Ofgem's enhanced powers put forward by the CMA, which look to allow Ofgem to take powers to initiate and prioritise or 'call-in' strategically important modifications, would be an effective substitute to their Significant Code Review (SCR) powers.

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<sup>1</sup> Such as Ofgem's Switching Programme, smart meter roll out, low carbon transition and the EU Third Energy Package

## 4. Next Steps

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- 4.1 Given the impacts the proposed remedies would have on DCUSA Ltd, namely Ofgem's licensing regime to introduce code managers, the secretariat invites the DCUSA Panel to discuss and agree whether to submit a response to Ofgem's consultation.
- 4.2 Where the DCUSA Panel agrees to submit a response the key questions that the Panel are invited to discuss to help shape the Secretariats drafting of a consultation response are:
- Which consultation questions (listed in Appendix 1) would the Panel wish to be responded to<sup>2</sup>?
  - Does the Panel agree DCUSA should be included within the scope of the new arrangements? Given the direction from the CMA there may be limited value and benefit in opposing this view.
  - Factors which should be considered for what is included as part of the scope of new code governance arrangements.
  - Which of the four models would the Panel prefer to be implemented for licensing and procuring the code manager for DCUSA and why?
  - Views on the purpose and scope of the strategic direction and the role of code Panels in its development and implementation?
  - The role of code Panels within the functions of the consultative board and how they should both interact?
  - The impacts of new arrangements to existing projects which may impact DCUSA/ DCUSA parties?
  - The Panels views on whether Ofgem's enhanced powers over strategically important modification proposals mean that Ofgem SCR powers will be obsolete?
  - How many licences or contract tenders should be run each year, in what order, and how frequent the re-competition of the positions (such as the DCUSA Code manager) should be (i.e. as 3-6 years)?

## 5. Workplan

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- 5.1 Subject to DCUSA Panel agreement that the Secretariat should construct a response to the Ofgem consultation on behalf of the Panel. The below timetable has been developed to ensure adequate Panel input of a consultation response to Ofgem ahead of the submission deadline of 1 February 2017.

Dates	Action
9 November 2016	Publication of Industry Code Governance Consultation
16 November 2016	DCUSA Panel discussion of contents of consultation response
14 December 2016	Secretariat to publish draft consultation response for Panel discussion
21 December 2016	Panel to discuss any comments or amendments to the consultation response
11 January 2017	Secretariat to publish second draft consultation response for Panel discussion

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<sup>2</sup> The Panel may view that not all questions are relevant to DCUSA arrangements, such as 2.2, 3.1 or 3.2

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18 January 2017	Panel to provide any final consultation comments
1 February 2017	Submission of Consultation Response to Ofgem

## 6. Recommendation

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6.1 The DCUSA Panel is invited to:

- **NOTE** the contents of the paper;
- **AGREE** whether to respond to Ofgem’s consultation;
- **AGREE** the scope and details to be included within the consultation response; and
- **AGREE** the proposed work plan for developing a consultation response.

## 7. Appendices

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Appendix 1 - Industry Code Governance Consultation Questions

**Naomi Anderson & Rachael Mottram**

## Appendix 1 – Industry Code Governance Consultation Questions

Work Stream	Question Number	Remedy
Scope of New Arrangements	2..1	Do you agree that the codes and functions we have identified (i.e. the codes within the scope of the CACoP and their associated central system delivery functions) should be within scope of the new regime?
Scope of New Arrangements	2.2	Are there any other codes or systems that should be within scope and if so please give your reasons?
Scope of New Arrangements	2.3	Are there any other factors you think we should consider when making this decision?
Licensing and Competition	3.1	What are your views on our proposed approach of including the code manager and delivery body function in a single licence?
Licensing and Competition	3.2	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?
Licensing and Competition	3.3	What are your views on the merits and drawbacks of the four identified models for competitively licensing code management where applicable?
Licensing and Competition	3.4	What are your views regarding which model(s) may be appropriate for different codes, or types of codes?
Strategic Direction	4.1	Do you agree with the purpose of the strategic direction?
Strategic Direction	4.2	Do you have any views on how the strategic direction should be developed and implemented?
Strategic Direction	4.3	How much detail do you consider should be included in the strategic direction?
Strategic Direction	4.4	Which specific projects do you consider should be included in the initial strategic direction?
Consultative Board	5.1	What do you see as the core role and functions of the consultative board?
Moving to New Arrangements	6.1	What are the main impacts of the proposed new arrangements on existing projects?
Moving to New Arrangements	6.2	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.



