

Code Governance Review – role of code administrators and small participant/consumer initiatives – initial proposals

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Overview:

This document sets out our initial proposals on the initiatives that we propose to progress, following our consultation in December 2008 on work strands relating to the **'role of code administrators'** and **'small participant and consumer initiatives'**. In line with the views of respondents, we are not at this time proposing major structural reforms, but consider that significant improvements can be made with proportionate changes to the workings and structure of the code panels, and in particular through the assistance offered to smaller market participants and consumer representatives by the code administrators. We are therefore proposing to introduce new obligations on code administrators to offer such assistance, enshrining the concept of the code administrators acting as a **'critical friend'**. We are also proposing measures to improve the transparency and accountability of code administrators for their costs and quality of service.

Contact name and details: Jon Dixon, Head of Industry Codes and Licensing

Tel: 020 7901 7354

Email: industrycodes@ofgem.gov.uk

Team: Industry Codes and Licensing

The Authority is committed to policies and processes that are consistent with better regulation principles and that reduce administrative burden on business while maintaining effective consumer protection.

As part of that commitment, in November 2007 we announced the Review of Industry Code Governance. We considered that such a review was timely given the changes that have occurred in the market, where the nature of participation is changing, particularly for new entrants and smaller players. The Authority's role in relation to code modifications has also changed with the introduction of additional statutory duties and the right of appeal to the Competition Commission.

In June 2008, we set out the scope of the Review and confirmed that a good governance regime should –

- promote inclusive, accessible and effective consultation;
- be governed by processes that are transparent and easily understood;
- be administered in an independent and objective manner;
- provide rigorous high quality analysis of any case for change;
- be cost effective;
- contain rules and processes that are sufficiently flexible to allow for efficient change management; and
- be delivered in a manner that results in a proportionate regulatory burden.

The Review is considering what changes are required to deliver these objectives. The review comprises several work-strands and a table setting out progress under each of these work-strands appears below.

Work-strand	Update
Major Policy Reviews and Self Governance	Ofgem consultation issued today – Responses due 18 September 2009
Role of Code Administrators and small participant/consumer initiatives	Ofgem consultation issued today – Responses due 18 September 2009
Charging methodologies	Ofgem consultation to be published shortly
Code objectives and the environment	Ofgem consultation letter issued 16 June - Responses due 29 July 2009
Complexity and fragmentation – Code Administrators Working Group (CAWG)	Consultation on initial CAWG Report closed 29 May 2009. CAWG to be reconvened. Ofgem update letter to be issued shortly

This document sets out our next steps proposals on **the role of code administrators and small participant/consumer initiatives**. The issues that it covers overlap to some extent with those covered in other work strands, in particular the CAWG.

- Open letter announcing review of industry code governance - 284/07, November 2007:

www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/Open%20letter%20announcing%20governance%20review.pdf

- Corporate Strategy and Plan 2008-2013 - 34/08:

www.ofgem.gov.uk/About%20us/CorpPlan/Documents1/CORPORATE%20STRATEGY%20AND%20PLAN%2028%20MARCH%202008.pdf

- Review of industry code governance - scope of review: 92/08, June 2008:

www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/GovRevScope%20-%20MF%20Final%2030%20JUNE%202008.pdf

- Code Governance Review: Charging methodology governance options, Ofgem, Ref: 132/08

www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/CGR_CM_Sept_FINAL.pdf

- Review of Industry Code Governance – Environment and Code Objectives, Ofgem Open Letter, 21 November 2008

www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/open%20letter%2020%20November%20draft%20_4_.pdf

- Review of Industry Code Governance – role of code administrators and small participant/consumer initiatives, 19 December 2008

www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/Code_admin_condoc_191208.pdf

- Review of Industry Code Governance – Code Administrators' Working Group - open letter, 20 April 2009

www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=41&refer=Licensing/IndCodes/CGR/CAWG

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Summary

Following on from our December consultation, this document sets out our initial proposals on the initiatives we plan to take forward regarding the role of code administrators and to facilitate the engagement of smaller participants, consumers and new entrants in the industry code arrangements and modification processes.

Respondents generally agreed with our view that over the recent years the code arrangements have worked reasonably well to deliver incremental reform and change, but that reform was required in order to meet the future challenges for the energy industry. In particular, it was acknowledged that the changing nature of the markets is leading to increased participation of smaller renewable and distributed generators, along with smaller suppliers, who are often less well resourced than the large incumbent market participants and may find it difficult to engage in the codes arrangements. There was therefore a degree of support for our proposals to reduce complexity and ease the burden of participation in the code modification procedures, with an acknowledgement that such initiatives would also benefit the larger parties.

However, industry participants did not generally consider that the existing code arrangements are fundamentally flawed, but did consider that they could be improved upon through relatively straightforward revisions. In particular, respondents generally felt that the necessary improvements could be achieved through changes to manner in which code administrators operate, rather than the underlying structure of their organisations or corporate governance. They also sought earlier engagement from Ofgem within the existing procedures.

We agree that in many cases the deficiencies with the current codes procedures we identified in earlier documents could be addressed through relatively straightforward changes to the way in which the codes administrators and panels operate, rather than necessarily requiring fundamental changes to their structure or funding.

However, we consider that there are a number of areas where improvements are required, particularly in order to deliver improved industry analysis of code modifications, and to assist new entrants, small participants and consumers. This document therefore sets out a number of relatively low cost proposals which seek to deliver these improvements. These proposals include:

- **Embedding a 'critical friend' approach for code administrators.** Under these proposals, code administrators would be required to ensure that all arguments for and against a modification proposal are discussed and reflected in modification reports. The 'critical friend' would also provide support to small participants and consumer interests engaging in the codes process.
- **Obligations to assist small participants and consumer groups.** We propose a new duty upon code administrators to actively engage with small participants and consumer groups, facilitating their participation in the codes processes.
- **'Call in' and 'send back'.** Powers to enable Ofgem to 'call in' modification proposals which are not being effectively developed or assessed at a speed relative to their importance, and powers to 'send back' proposals where analysis is deficient.

- **Published reasons for panel recommendations.** The extent to which panels provide reasons for their recommendations differs considerably across codes. We propose licence changes requiring the provisions of transparent reasons;
- **Independent panel chairs.** In order to ensure that the panel chair is independent, we propose to introduce a requirement that UNC and CUSC chairs be appointed by the Authority. This is the current practice under the BSC;
- **Performance evaluation measures.** We propose regular benchmarking in order to improve transparency on the relative performance of the code administrators and to increase accountability for costs and quality of service;
- **Code of practice for code administrators.** We propose that a code of practice be established to facilitate convergence and transparency in code change processes and to help protect the interests of small market participants and consumers through various means including increased use of plain English in modification reports.

The proposals set out above are intended to apply to the main codes, namely the UNC, CUSC and BSC.

Ofgem has also today published its initial proposals on amending the code modification governance arrangements to allow for Ofgem led Major Policy Reviews and for industry self-governance arrangements. We consider that the proposals contained within this document complement those contained in the Major Policy Review and Self Governance initial proposals document. In particular, proposals that improve the functioning of the code panels will make it more likely that any decisions that are made under self-governance will be transparent and robust.

Way Forward

We recognise that many, if not all, of our proposals could be appropriately implemented via changes to the code modification rules. However, in the absence of such modification proposals and in order to ensure a degree of consistency across all of the codes, we intend to formally consult on licence modifications as part of our Final Proposals in early 2010.

There is an important overlap between this work-strand and the work of the Code Administrators Working Group ('CAWG'). The group was established in order to explore and progress opportunities for the convergence of code modification processes which could be realised without structural change, for instance through modification to the existing rules or simply changing custom and practice. This group was composed of cross industry members, including the code administrators, industry participants, Consumer Focus and the Better Regulation Executive.

Given the success of the CAWG in identifying the practical issues which impact upon users' experience of the codes and arriving at a consensus on how they may be tackled, and the degree of overlap between its recommendations and our own proposals for a Code of Practice, we consider that this initiative can be best taken forward by that group. We therefore propose to reconvene the CAWG late in the autumn. In the meantime, the code administrators have agreed to develop a draft of the Code of Practice document, which will subsequently be presented to the CAWG for comment.

1. Introduction

Background

1.1. In November 2007 we initiated the Review with an open consultation. We commenced the Review because:

- the major codes had been introduced some time ago and since then there had been significant changes in the market and regulatory landscape, which raised the possibility that the governance arrangements may no longer be optimal;
- the Authority's statutory duties had changed, for example with the inclusion of duties relating to sustainability and better regulation;
- certain decisions of the Authority in relation to code modifications were now subject to appeal to the Competition Commission;
- the Authority was now required to undertake impact assessments before reaching certain important decisions, including in relation to some code modifications;
- the nature of the market place had evolved, in particular with the entry of smaller players including renewable and distributed generators; and
- concerns had been expressed by small market participants that the existing code arrangements were too complex and inaccessible, particularly for the smaller new entrants, and that weaknesses in the governance regime prevented industry and consumers getting full value from the code arrangements.

1.2. The nature of the regulatory issues facing industry participants, Government and Ofgem is becoming more challenging in the face of climate change and, from a security of supply perspective, Great Britain's increasing dependence on external energy sources. Ofgem considers that the codes arrangements have been severely tested in key strategic reform areas that are significantly impacted by public policy issues such as sustainable development and security of supply. In some cases, the codes arrangements have hindered progress in key areas of policy development. Electricity cash-out and transmission access reform are two such areas.

1.3. It is important to emphasise that, given the evolving nature of the market as well as developments in the Government's energy and sustainability policies, it is very likely that further strategic issues will arise over the coming years which have significant impacts on the codes arrangements.

1.4. In June 2008 the Authority published its decision on the scope of a review of Industry code governance ('the June document')¹. The Authority decided to initiate a major programme of work on the codes and charging methodology governance arrangements to ensure that they remain fit for purpose and preserve competition in a changing market landscape. The programme of work has a number of work-strands. Two of the key work-strands relate to the role of code administrators and initiatives that are intended to facilitate the engagement of small participants and consumers in the codes arrangements.

1.5. In December 2008, Ofgem published an initial consultation document ('the December document') covering the role of the code administrators in administering the codes processes and setting out a series of proposals to assist small participants and consumers to engage in code modification processes. The December document identified a number of key problems associated with the existing governance arrangements, which included:

- concerns about the quality of analysis that is produced by the industry in support of change proposals raised through the code modification processes;
- significant differences in the level of accountability for costs and quality of service of the code administrators. In addition the variety of governance structures increases complexity and opacity;
- small market participants and new entrants regularly face difficulties in engaging in the code modification process which can become dominated by larger incumbent energy companies. There is also little direct consumer engagement at working group level and relatively few consumer sponsored modification proposals.

The Industry Codes Governance Review Objectives

1.6. The various options set out in the remainder of the document are designed to address the key problems identified above. As with all the work undertaken for the governance review, our fundamental objective is to develop an overall set of code governance arrangements that leads to more effective and efficient decision-making in line with the criteria set out in the November 2007 letter:

- promote inclusive, accessible and effective consultation;
- be governed by rules and processes that are transparent and easily understood;

¹ See Ofgem's "Review of industry code governance – scope of the review", Decision document, June 2008

- be administered in an independent and objective fashion;
- provide rigorous and high quality analysis of the case for and against proposed changes;
- be cost effective;
- contain rules and processes that are sufficiently flexible to circumstances that they will always allow for efficient change management; and
- be delivered in a manner that results in a proportionate regulatory burden.

Related work – Code Administrators Working Group (CAWG)

1.7. In 2008 as part of the Review, we convened an Ofgem chaired working group, known as the CAWG. The objectives of the CAWG was to explore, identify and progress opportunities for:

- making the code modification process more accessible, usable and transparent for all parties including consumers, new entrants and smaller market participants; and
- encouraging best practice and, where appropriate, the simplification and convergence of code modification processes.

1.8. The group comprised members from the code administrators (Elexon, Joint Office, National Grid (NG)) as well as industry participants from all sectors of the gas and electricity industries, including Edf Energy, Good Energy, RWE, Centrica, E.ON, MEUC, Association of Electricity Producers and Cornwall Energy. Representatives from Consumer Focus and the Better Regulation Executive also attended.

1.9. The group met on 5 occasions and focussed its work on improving the code change arrangements under the Balancing and Settlement Code (BSC), the Connection and Use of System Code (CUSC), and the Uniform Network Code (UNC). Ofgem published a report setting out the CAWGs conclusions in April 2009². The CAWG report made a number of recommendations governing the code change arrangements, some of which overlap with the policy proposals that are discussed in this document and our December document. A number of the proposals set out in

²www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=41&refer=Licensing/IndCodes/CGR/CAWG

this document and our December document (including the Code of Practice) originated from the work of the CAWG.

1.10. In the April 2009 CAWG report there was support for code administrators to be subject to a Code of Practice (setting out principles to which the modification rules and where appropriate the code administrators themselves should adhere), and for requirements on code administrators to act as 'critical friends'. The CAWG report also recommended that plain English terminology should be used in all modification reports.

1.11. Ofgem's letter consulting on the CAWG report indicated that we intended to proceed with the development of the Code of Practice and sought views on the status of the Code of Practice, including whether it should be binding or voluntary. The consultation on the CAWG report ended on 29 May 2009. Ofgem intends to publish its own recommendations from the CAWG report in the light of respondents' views shortly. We also intend to reconvene the CAWG to facilitate the development of the Code of Practice. The Code of Practice is discussed further in Chapter 2.

Purpose of this document

1.12. The purpose of this document is to set out our initial proposals for reform, building on the December document and in the light of respondents' views. We also consult on our assessment of the package of reforms as compared with the existing arrangements.

1.13. We would welcome written responses on this document by 18 September 2009. Further details on how to respond to this consultation are set out in Appendix 1.

1.14. Having considered responses to the document we intend to publish our Final Proposals by January 2010.

Structure of document

1.15. The remainder of this document is structured as follows:

- chapter 2 summarises the views of respondents to the December document and sets out Ofgem's views; and
- chapter 3 describes the proposals we would like to take forward and on which we are consulting further.

Given that some of the original options for reform are no longer included in our initial proposals our impact assessment has been revised accordingly; the revised assessment of the impact of the options discussed in this document is set out in Appendix 3.

2. Discussion of responses to December document

Chapter Summary

This chapter summarises the responses to each of the questions raised in our December document and sets out Ofgem's views.

Role and responsibilities of the Code Administrator

2.1. In the December document, we raised two issues relating to the role of code administrators. First, we considered whether code administrators should play a more active role in the modification process and outlined two possible options for change: the **critical friend** and **active secretariat** approaches. Second, we discussed whether code administrators should also have responsibility for running the key systems associated with their codes e.g. the settlement and other communications systems.

2.2. All the code administrators have a secretariat role for code modifications: they coordinate and chair modification meetings, compile modification reports and publish modification related documentation on their websites. Whilst some code administrators, such as Elexon, provide assessments of the impact of code modifications on the central systems, generally most administrators do not provide additional market assessments to those that are carried out by modification working groups (or work-streams) and panels. Their role is largely to report the analysis carried out by modification groups and the views expressed by respondents to modification consultations.

2.3. In the December document, and throughout the governance review, we have highlighted our concern that the quality of assessment provided for modifications is often inadequate. This can either be because important potential impacts have not been analysed or because the analysis that has been carried out is flawed in some way e.g. with respect to the assumptions made or the data used. We considered that these quality problems might be reduced if the code administrators were to play a more active role in the modification process.

2.4. As regards the code administrator having responsibility for the systems associated with its codes, we pointed out that, at present, there is a fairly even split between the code administrators who have responsibility for systems and those who do not. We considered that greater transparency should result from code administrators having responsibility for systems but, on the other hand, there could be conflicts of interest between the two roles.

Critical friend or active secretariat

2.5. In the December document we proposed two high level options for change: the **critical friend** and **active secretariat** approaches. Under the critical friend option, the code administrators' role would be expanded to include challenging the terms of reference put forward by the panel, the analysis carried out by the modification group, the reasoning put forward by consultation respondents, and the conclusions drawn by panel members in reaching their recommendation. In other words, the code administrator would act as a 'devil's advocate', testing the appropriateness of the analysis that is being contemplated and the strength of the conclusions that can be drawn. The active secretariat option takes the critical friend idea a significant step further by giving the code administrator a much greater role in assessing code modifications. For example, the code administrator would have primary responsibility for the quality of the assessment that is performed.

Respondents' view

2.6. Respondents to the December document were generally of the view that the quality of analysis of modification proposals was adequate. To the extent that there were problems with the analysis, several respondents suggested that this could best be tackled by earlier and more active engagement by Ofgem in the modification process. They pointed out that code administrators often had difficulty in persuading modification groups to provide more relevant analysis and considered that this difficulty might persist even if code administrators played a more active role.

2.7. Some respondents considered that code administrators already acted as 'critical friends' and a few suggested that at least some administrators undertook the 'active secretariat' role. However, respondents did acknowledge that the quality of modification analyses and reports might be enhanced if code administrators played a more active role.

2.8. There were mixed views on the consequences that would follow from code administrators adopting a more active role. Some respondents were concerned that this would undermine their independence and impartiality, particularly if the 'active secretariat' role was adopted. Other respondents considered that the result would be beneficial in that the change processes would become more robust. In particular, the CAWG came out strongly in favour of code administrators adopting the 'critical friend' role.

Ofgem's view

2.9. Ofgem continues to believe that there would be advantages in developing and defining the role of the code administrators of the major commercial codes (the UNC, CUSC and BSC). In particular, we continue to hold concerns regarding the adequacy and quality of analysis undertaken on code modification proposals and we have raised concerns on analysis in a number of code modification decisions we have made over the past year³. We also continue to believe that by having code administrators challenge reasoning put forward by consultation respondents and set out clearly all arguments for and against the modification, modification reports should become more transparent.

2.10. Whilst we do not consider that either the 'critical friend' or 'active secretariat' would compromise the independence or impartiality of the code administrators, we recognise the strong views of many industry participants who feel that it may be inappropriate for them to take such a lead on instigating change. **Having taken into account respondents' views, we consider that a requirement should be introduced on code administrators to adopt the 'critical friend' role.** We also consider that, the relative balance of costs and benefits also favours the more incremental change of moving to a 'critical friend' administrator. In Chapter 3 we set out in more detail our initial proposals in this area.

2.11. Whilst we are proposing to introduce the Critical Friend approach at this time, this does not preclude the possibility that, at a later stage, it might become appropriate to take the additional step of moving to an 'active secretariat' role.

2.12. In terms of Ofgem's role in the code process, we would reiterate our statements from the December document. In particular, whilst Ofgem endeavour to provide guidance to code panels wherever possible, as we have no control over the timing of modification proposals being raised there may not always be sufficient resources or appropriate expertise available at the particular time of asking. Further, issues are not always immediately apparent and it is often the case that Ofgem will not be able to identify deficiencies in analysis for instance until a modification report is submitted and it has had time to conduct its own detailed review.

Systems role

2.13. The December document noted that at present there is a fairly even split between the code administrators who have responsibility for systems and those who do not, as follows:

³ For instance, see UNC proposal 149/149a, BSC proposal P224 and CUSC proposal 131, the decision letters for which are available on the Ofgem website at: www.ofgem.gov.uk

- **Administrators with responsibility for systems:** Elexon (BSC), National Grid (NG) (CUSC and Grid Code) and Genserv (MRA)
- **Administrators without responsibility for systems:** JO (UNC)
- **Codes with no central systems:** Distribution Code (ENA), DCUSA (Electralink), iGT UNC (Genserv), SPAA (Electralink) and STC (NG)

2.14. Experience to date suggests that there are advantages and disadvantages to both approaches, mostly related to the interaction between systems costs and code modifications. We therefore sought views on whether the roles of the administrators of the BSC, UNC, CUSC, Grid Code, SPAA and MRA in respect of central systems management be harmonised—i.e. whether all code administrators should be made responsible for the related systems, or whether this responsibility should be removed from them all.

Respondents' view

2.15. Relatively few respondents commented explicitly on the desirability of merging the code and systems administration roles. Those respondents who did provide comments did not consider that merging the functions would lead to the benefits that Ofgem was hoping to achieve – namely improved information and transparency benefits associated with the system cost implications of modifications. While several respondents expressed concerns, particularly regarding xoserve's⁴ performance in these respects, they were generally of the view that management responsibility was not the key issue, but argued that they should be addressed through the introduction of specific obligations to provide data and the removal of potentially conflicting commercial interests.

2.16. More generally, it was apparent from responses that any improvements needed to be tailored to the existing arrangements under each codes rather than seeking to adopt a uniform approach across codes.

Ofgem's view

2.17. At this time we are not convinced that there is a case for major structural reforms that would change the governance of core systems in gas or electricity. Whilst the creation of independent board structures governing systems and code administration under the UNC, with more diverse industry participant ownership, might help to address some of the concerns that have been expressed, this would be a complex and costly exercise. At this time, we therefore agree with those

⁴ xoserve administers the systems associated with the UNC.

respondents who suggested that clear, targeted obligations around the publication of information would be more likely to deliver the necessary improvements, irrespective of organisational structure. However, we intend to continue to monitor the effectiveness of the existing structural arrangements. Further, to the extent that there is industry support for structural change in this area, we would be open to giving this issue further consideration.

2.18. We consider that there has already been a marked improvement in the provision of information on system costs necessary to fully analyse modification proposals under the UNC since the introduction of the User Pays concept. In particular, in line with procedures introduced as part of UNC modifications 188⁵ and 213, xoserve can now be required by the UNC panel to produce a 'Rough Order of Magnitude' and if necessary a subsequent 'Detailed Cost Assessment' setting out the likely system costs of a proposal. Whilst there have as yet been few User Pays modification proposals to have proceeded fully through the process, we understand the general feeling amongst both Gas Transporters and Users is that the process has worked relatively well. It is likely that further improvements will be made to the information provision; these will be as a result of suitable modifications being brought forward to capture any lessons learnt as modifications proposals progress.

2.19. Such targeted modifications proposals offer a proportionate means of addressing shortcomings in the current arrangements.

2.20. Notwithstanding the points raised above, we would welcome further views on whether there are alternative ways of ensuring that the information is made available in a timely fashion, and in particular whether there is any role for Ofgem beyond its participation in the modifications process.

Governance and Funding

2.21. Chapter 4 of the December document pointed out the widely varying approaches to the governance of code administrators and considered the issues that currently exist in relation to governance and funding. First, we considered whether there was a case for code administrators to be independent from network businesses. Second, we set out a range of options for reforming the governance of the code administrators including independent company and board structures and we highlighted the need for clearly defined objectives, outputs and targets for code administrators and their staff to ensure that they are accountable for their performance. We also explored a more light-handed reform approach of requiring all major codes panels and boards to have independent chairs appointed by Ofgem. Lastly we discussed whether there would be advantages in having a uniform funding arrangement for all code administrators and, if so, what it should be.

⁵ See: www.ofgem.gov.uk/Licensing/GasCodes/UNC/Mods/Documents1/UNC188%20D.pdf

Corporate governance options

2.22. In several cases the administration of the industry codes is undertaken by network businesses and is therefore not managed as a separate independent function. This has the potential to create conflicts of interest which are discussed further below.

2.23. In the case of the CUSC, Grid Code and STC, NG acts as code administrator. We consider this has the potential to create conflicts of interest. In the case of the UNC, the code administration function is undertaken by the Joint Office, staffed by seconded employees of the gas transporters, though they are under duties to act independently in the performance of services to the Joint Office. At the opposite end of the spectrum, the code administration function for the BSC, SPAA, MRA and DCUSA is already carried out by quasi independent companies, who may be owned by but operate at an 'arms length' from licensees.

2.24. We therefore asked whether the code administrators should be independent of network owners. We also asked whether it is sufficient to have management unbundling or whether the code administrator should be a wholly independent company.

2.25. We set out below three different corporate governance options for code administration:

1. **Close integration between the code administrator and the relevant network owner(s)**. As noted above, this is the option that applies in respect of the Grid Code, the CUSC, the UNC and STC, and represents the status quo for the administration of these codes.
2. Some integration between the code administrator and the relevant network owner(s) but with **management unbundling (ring fencing)**.
3. **Independent company and board structure**. Under this option the code administrator is an independent company although the code panel may contain representatives of the network owner(s). Under this option, the code administrator could also be appointed for a fixed term by the network owner(s) (and also potentially, market participants) following a competitive tender.

2.26. We noted that the third option in particular would require significant changes to the code administration of the CUSC and UNC⁶. A key issue is therefore whether the introduction of corporate structures is a proportionate response to the issues outlined above, particularly if they continue to have no responsibility for the code systems.

⁶ In the June document, the Authority decided that the Review should not explore the possibility of independent board structures for the Grid Code or the Distribution Code.

2.27. The December document also noted that three different types of funding arrangements currently exist for code administrators, as follows:

- pass through (BSC);
- service contracts, (SPAA, MRA, Distribution Code, DCUSA) and;
- price control funding (CUSC, Grid Code, UNC).

2.28. We noted that to the extent that board or company structures are introduced for the administration of the UNC or CUSC it is necessary to consider the funding arrangements underpinning these structures. We therefore sought views on the models for funding outlined above. We also asked whether the existing funding arrangements for Elexon should be changed from 'pass through' to an alternative approach.

Respondents' views

2.29. There was no support amongst respondents for the idea of setting up the code administrators for the UNC and CUSC as independent companies, along the lines of the BSCCo (Elexon). The general view was that it would be costly to implement and would not necessarily be particularly effective – it might even reduce transparency and accountability. Moreover, some respondents were concerned that complete unbundling would reduce the level of expertise available from the code administrators, particularly in the case of the CUSC. One respondent did, however, suggest that there could be benefits from transferring code administration to Community Interest Companies, so as to introduce a corporate social responsibility approach to governance with panel members having a fiduciary duty to code parties and others.

2.30. The general view of respondents on funding mechanisms was that it was appropriate to have different mechanisms for different codes. A further point raised by several respondents was that the mechanism itself was relatively unimportant and what really mattered was that there was transparency and accountability over how costs were incurred and funding obligations set. Of those respondents who did express a view on the relative merits of the different funding mechanisms, there was a clear preference for the service contract approach.

Ofgem's views

2.31. We remain of the view that the creation of board and company structures could provide the optimal framework for ensuring that objectives are sufficiently defined, delivering accountability and independence and ensuring that performance can be effectively measured.

2.32. We also consider that there is merit in the concept of introducing service contract structures for codes such as CUSC, BSC and UNC. We consider that such structures have the potential to promote competition in the provision of code administration services. For example, under these approaches, code owners could potentially tender out the provision of code administration services for a defined

period, enabling different organisations to compete for the provision of these services. From a competition perspective we consider that this approach is preferable to adopting cost pass through approaches, where there is less accountability over cost and quality of service. In this context, making the provision of such services regularly open to competitive tender should help to promote efficiencies in the administration of the UNC, CUSC and BSC arrangements, as well as increasing accountability on quality of service.

2.33. We acknowledge that there could be significant initial costs in the establishment of company/service contract structures. In addition, any such changes would need to be progressed with a significant degree of industry support, particularly if the ownership were to be wider than the existing network operators. We are therefore not proposing to require the introduction of such arrangements as part of this governance review.

2.34. However, we believe that there is merit in the introduction of service contract structures being given further consideration by industry participants and parties to the UNC, CUSC and BSC. This could potentially be considered through governance work-streams or industry issues groups. We would also note that there is nothing to preclude consideration of the introduction of service contract structures by the respective licensees, i.e. the gas transporters in respect of the UNC and National Grid in respect of the CUSC and BSC.

2.35. For the reasons outlined above, while we are not proposing such reforms at this time, we remain open to considering further change in this area in the event that there is more support from industry participants to embark upon such a project.

Role of Elexon

2.36. In the December document we reviewed the governance surrounding the Elexon board. We noted that the Elexon board structure is intended to provide an important discipline on the Elexon management team both generally and in terms of budgets. However, we also noted that there may be issues regarding the incentives on the Elexon board and senior management to manage costs and quality of service effectively, particularly given that its costs are passed through to industry participants. We sought views on these issues and whether there are sufficiently defined objectives, deliverables and performance measures for Elexon against which its performance can be measured.

2.37. We also sought views on whether it is appropriate for the role of the Chair of Elexon to continue to be combined with the role of the Chair of the BSC panel or whether this creates some conflicts of interest or other complications.

Respondents' views

2.38. Very few respondents commented on this issue. One respondent noted that Elexon's costs and performance targets are not set by the parties who receive the services and pay for them and that it is inappropriate for the service provider to set

its own costs and service levels. However, Elexon considered that its costs are entirely transparent, being regularly reported in its monthly Change Report. It also noted that it encourages dialogue with its customers on its activities and expenditure, and that feedback to its customer survey was generally positive.

2.39. There was no support from respondents for any changes to the existing arrangements for the chair of Elexon and the chair of the BSC panel. Elexon submitted that there are no conflicts of interest within the current arrangements as Elexon is a not for profit business and it therefore has no interest in influencing the costs of modification solutions. Elexon also noted that the objectives of the BSC panel and Elexon are the same in any event.

Ofgem's views

2.40. We consider that whilst Elexon remains able to pass through its costs to industry participants, it is important that there is a high level of accountability for the services it provides. The company based governance structure goes some way to delivering this accountability by creating a board structure which oversees the Elexon management team. We also note that the company structure in combination with the BSC ensure that there is a significant level of transparency over Elexon's costs and strategy.

2.41. Whilst this is the case, we nevertheless consider that more could be done by Elexon to ensure that its corporate objectives, deliverables and performance measures are clearly defined, particularly given that it is able to pass through its costs. Whilst there is transparency over costs, little information is provided in the public domain on performance targets or other mechanisms used to ensure the accountability of Elexon and its management team. For example, whilst Elexon publishes a Corporate Strategy and Annual Report⁷, including performance against budget etc, we believe that there would be benefits in Elexon publishing further information on the key performance indicators over the services that it provides, and to also report on performance against these indicators in its Annual Report. This may also give greater transparency to funding parties on the effectiveness of the Elexon board in both controlling costs and improving services.

2.42. We note that while the Joint Office is accountable to a committee of the Gas Transporters under the terms of the Joint Governance Arrangements Agreement (JGAA)⁸, the operation of this committee and any measure of performance of the Joint Office it may undertake are not published. Whilst recognising the differences in their relative constitutions, we see no reason why the Joint Office should not publish an Annual Report along similar lines to the Elexon report mentioned above. Although

⁷ See: www.elexon.co.uk/documents/Publications/Current_Annual_BSC_Report/Annual_BSC_Report.pdf

⁸ See: www.gasgovernance.com/NR/rdonlyres/CF1AC9AC-55DB-4EB0-AD2A-B77237F27204/25283/JGAAV20.pdf

the administrative functions of the CUSC are carried out solely by National Grid, we see no reason why it should not be required to similarly report.

2.43. We would welcome comments from respondents on these issues including whether there are other mechanisms available to increase Elexon, the Joint Office and National Grid's accountability.

2.44. As noted above, in our December document we also discussed the potential for the position of chair of the BSC panel and chair of the Elexon board to be separated. We have decided not to proceed with any proposals to separate these positions at this time. Indeed, Ofgem will shortly be commencing a selection process for the new chair of Elexon and the BSC panel and this will be undertaken on the basis that the roles are not separated into 2 different positions. In reaching this position, we would note that whilst the roles are different in nature, we accept Elexon's argument that, at least under the current structural and governance arrangements, there are unlikely to be significant conflicts of interests associated with one individual holding each role.

Independent chairs

2.45. In the December document we discussed the need for code administrators and the panels themselves to operate in a manner which best serves the interests of all code parties, rather than being subject to potential undue influence from the relevant network operator or parties responsible for the funding of the code administrator. We were also concerned to ensure that the code administrators, whilst independent, were accountable for their performance in delivering the objectives of the relevant code.

2.46. Whilst we discussed a range of possible models to balance the needs of independence and accountability, such as the establishment of board structures where none exists, we noted that a simpler and potentially more proportionate mechanism would be to require all major commercial code panels to have an independent chair, appointed by Ofgem. In addition to their role on the modification panel itself, the chair could have a role in overseeing the activities of the code administrator. The codes that would be affected are primarily the CUSC and the UNC.

Respondents' view

2.47. Few respondents commented directly on whether panel chairs should be independent. A small number were in favour of the idea including some small market participants and Consumer Focus. Some other respondents thought it unnecessary, with one respondent suggesting that appointment by Ofgem is likely to increase costs, particularly as it is likely to be a part time role that could not be offset against other duties.

Ofgem's view

2.48. We remain of the view that the introduction of Ofgem appointed independent chairs for the UNC and CUSC are likely to provide important benefits. Whilst the CUSC and UNC panel chairs have duties under the CUSC and JGAA respectively to act independently, we consider that the appointment of independent panel chairs for the UNC and CUSC would deliver more effective independent oversight. In the case of CUSC this is particularly important as the transmission arrangements continue to evolve with the establishment of more transmission asset owners under the offshore wind framework.

2.49. In addition, the presence of an independently appointed chair might also increase the robustness of industry assessments and may also help to ensure that small participants and consumer representatives are provided more assistance in engaging in code processes. In particular, we consider that an independent chair would help to ensure that modification reports are balanced and set out the full range of arguments for and against modification proposals. In this respect, the role of the independent chair would help to ensure that the 'critical friend' model is properly implemented by code administrators.

2.50. The importance of having an impartial chair will also increase if some degree of self-governance is introduced. The importance of having independent chairs relates to the influence that they can bring to bear to ensure that panels judge modifications on their merits. Consequently, the panel must be provided with sufficient information for this to be possible, which links to the need for adequate analysis at the modification group level and hence to the advantages of the 'critical friend' role for code administrators.

2.51. We therefore have included as part of our initial proposals that the Authority become responsible for appointing the chairs of the CUSC and UNC panels. Further details on these proposals are set out in Chapter 3.

Other potential improvements

2.52. In the December document, we discussed some changes that could be made relatively quickly:

- the ability for Ofgem to **call-in** and **send-back** modifications;
- requiring code **panels to provide reasons for their recommendations**;
- enabling **code administrators to raise code modifications**;
- introducing a **code of practice** for all code administrators; and

- creating **performance evaluation measures** for code administrators.

'Call in' and 'send back' proposals

2.53. The December document consulted on introducing the power for Ofgem to:

- **'call in'** a modification when Ofgem consider that its progress is too slow relative to the issue it seeks to address, discussion is going beyond the scope of the proposal or where the analysis being undertaken is in any way inadequate; and
- **'send back'** modifications reports sent to Ofgem, where we consider that the analysis contained within the report is insufficient to base a decision upon.

Respondents' views

2.54. Most respondents suggested that there would be no need for 'call in/send back' powers if Ofgem were more engaged in the modification process. However, some respondents could see a need for a 'send back' power' to prevent modifications being rejected due to inadequacies in the analysis and then subsequently being raised again. Other respondents could see a limited need for a 'call in' power but only where Ofgem considers that the proposal does not take adequate account of 'bigger picture issues'.

Ofgem's view

2.55. We remain of the view that the 'call in' option would enable Ofgem to call a code panel to account if we consider that the progress of a proposal is being unduly impeded or is not being afforded sufficient resources relative to the importance of the issue. We recognise the issue raised by respondents who suggested that Ofgem intervention may also be required if a proposal must appropriately be considered alongside other matters, potentially outside of the relevant code, in or to come to a complete view on the bigger picture. Whilst this is, in part, an issue that our proposals on Major Policy Review proposals are designed to address, we consider that it may also be a consideration for proposals which are following the normal modification route (i.e. 'path 2').

2.56. Whilst we will endeavour to provide as much assistance in the initial scoping of analysis, for instance in the Terms of Reference for a workgroup, this route may also allow us to provide further guidance later in the process, for instance if new issues come to light. Some code processes already provide for Ofgem to give a view on proposals, which can have a similar effect, though this is only at the panel's request.

2.57. We also consider that the introduction of a 'send back' power would be advantageous, particularly as it would allow for any deficiencies in the analysis of a proposal to be addressed prior to a decision being made, rather than potentially placing us in the position of having to reject the proposal and taking the initiative back to square one. Whilst Ofgem can already provide input regarding the assessments that it considers necessary (and has), it is not always possible to do this

early in the process. For example, it may not be until Ofgem has closely analysed a modification proposal once it has been submitted that the deficiencies in the analysis become apparent. In addition, as mentioned above Ofgem may not always have sufficient resources or necessary expertise available to identify concerns in the relatively narrow window of opportunity early in the modification process. Further, it may only become apparent at a late stage that some important aspect of analysis is missing, perhaps as a result of other developments or other modifications. The 'send back' option therefore provides the flexibility for the deficiencies to be addressed at this later stage before the modification decision is issued.

2.58. We understand the comments of those respondents who suggested that Ofgem has the opportunity to raise issues earlier in the process and does not need to wait until the final modification report ('FMR') is received to comment. Indeed we have previously committed to open dialogue during the development of a proposal, recognising that no comments made by the Ofgem representative can fetter the discretion of the Authority over the final decision. However, we remain of the view that these fall-back powers are appropriate and proportionate for the reasons outlined above.

2.59. We also note that there are precedents of similar 'send back' / 'call in' arrangements elsewhere. For example, the Irish regulator⁹ has the power under section 2.218 of the Trading and Settlement Code¹⁰ for the All-Ireland Market to "direct the Modifications Committee that further work is required in respect of the Modification Proposal". In addition, the SPAA provides that:

"If reasonably requested by the Authority (having regard, in particular, to the resources available to SPAA EC), in relation to any proposal for a change to any provision of this Agreement provide or procure the provision of advice and assistance to the Authority as soon as reasonably practicable as to the implications of the change and the actions necessary to implement it (including any relevant impact assessment)".

2.60. We consider that some of the opposition to the proposals may have been on the assumption that it would only apply at the end of the process once an FMR is received, and possibly make our early engagement less likely. However, there have been occasions when Ofgem has provided information on the types of analysis that it considered would be necessary for it to make a decision but this input has not been forthcoming. In this context, the 'call in' power could be used to allow Ofgem to require that particular analysis be conducted ahead of the FMR being delivered to us. Under this approach an FMR would also be considered incomplete until this analysis is complete and at risk of being sent back to the relevant panel. We note that the SPAA provision is in no way time bound and consider that a similar provision in the

⁹ The Commission for Energy Regulation and the Northern Ireland Authority for Utility Regulation.

¹⁰ www.sem-o.com/MarketRules/

three main codes could ensure that necessary analysis is conducted or issues considered.

2.61. The 'call in' power would also enable Ofgem to issue directions governing the timing of modification proposals. The Authority already has the power to grant urgent status to a proposal where requested. This usually entails providing a timetable for the proposal to follow. However, there are instances where timing issues manifest themselves with proposals which did not initially start out as urgent. These issues could relate to delays in the development of a proposal. There may also be a practical requirement to expedite the normal process in order to meet some external milestone, for instance in order to allow the proposal to be considered alongside matters being progressed elsewhere. 'Call in' powers could also be used to hold the relevant panel to account where, for example, Ofgem was concerned that vested interests may be unduly delaying the consideration of a proposal or work on the proposal. We would therefore envisage that these 'call in' provisions would prompt revised plans to be agreed with the relevant panel, or potentially the terms of reference of a sub-group to be reviewed.

2.62. We recognise that expediting development can itself create risks insofar as analysis etc may not be fully completed, or to the desirable standard, and would therefore only use such powers, where on balance, we consider the timing of the decision to be crucial and that on the basis of the information to hand, further analysis is unlikely to change the outcome of the decision.

2.63. We have therefore included the 'call in' and 'send back' powers in our initial proposals.

Requirements on panels to provide reasons for their recommendations

2.64. In our December document we proposed introducing more explicit requirements for code panels to give reasons for their recommendations on modification proposals to the Authority. We consider that imposing a requirement on code panels to provide reasons for their recommendations would add transparency and clarity to the modification process and act as a useful discipline on panel members by requiring them to explain their thinking in respect of particular modifications.

2.65. We also consider that if self-governance is introduced, it will be particularly important that the reasoning of code panels is recorded, since they will be acting as decision making bodies rather than simply making recommendations.

Respondents' views

2.66. There was widespread support for the introduction of a requirement for panels to publish reasons for their recommendations. The majority of respondents agreed that the provision by the relevant panel of a robust rationale for its decisions, based on the relevant objectives of the code, was a good governance practice. Whilst no respondents were opposed to our proposal, one suggested that the voting on panel

recommendations is already transparent, though agreed that more might be needed in the context of self-governance. Another respondent commented that a rationale from the panel would only be required where it overturned the recommendation of the working group.

Ofgem's view

2.67. We acknowledge that some panels do already provide reasons for their recommendations. However, we remain of the view that the rigour applied to those reasons differs significantly between codes, as does the extent to which they are recorded with explicit reference to the relevant objectives of the code. We also recognise that the approaches differ across the codes with respect to the role of the working, or development, group who may themselves provide a recommendation. We consider that irrespective of whether the recommendation is being made at the group or panel level, they should be based on the same criteria, i.e. the relevant code objectives.

2.68. We recognise that the different approaches to the provision of reasons may owe as much to the requirements formally placed upon the panels as to the custom and practice that has evolved over the years. We therefore propose to clarify the obligations that already exist within the code owners' licences such that the reporting of recommendations must be based upon and explained by reference to the relevant objectives.

2.69. In summary we have included as part of our initial proposals requirements on code panels to give reasons for their decisions. This is discussed further in Chapter 3.

Allowing code administrators to raise modifications

2.70. In the December document we suggested that code administrators may be well placed to identify parts of their code which are inefficient, redundant or not in line with the relevant code objectives. Under such circumstances, we considered that it could be appropriate to allow the code administrator to raise a modification directly rather than being reliant upon a code signatory.

Respondents' views

2.71. Only four respondents were in favour of this proposal, and two of those suggested that proposals should only be raised with the agreement of the panel. Another suggested that this would be of use where no individual party is inclined to raise the modification. Those who were opposed generally felt that it would undermine the independent nature of the code administrator's role.

Ofgem's view

2.72. In general we remain of the view that code administrators are as well placed as parties, if not better placed, to identify deficiencies in their respective codes and identify potential remedies. We also do not accept that the ability of a code administrator to raise a modification proposal would undermine its independence. This is because the modification proposal would proceed through a standard process of consultation with the relevant code panel reaching a final recommendation on the proposal. However, we also recognise that code administrators may be reluctant to utilise these new powers if to do so would attract the level of criticism suggested in responses to our proposal.

2.73. We note that under the BSC, Elexon already have the ability to bring forward suggestions to the panel, which are then taken forward as panel proposals. We consider that this has proven to be of use in the past, where issues have been identified which require resolution, but may not be sufficiently material for an individual party to progress, or where the benefits would be shared equally.

2.74. Therefore, rather than allowing code administrators to raise modification proposals directly, we instead propose that the ability to raise modification proposals which improve the efficient administration of the arrangements is extended to the UNC panel. We note there is some confusion as to whether the CUSC panel already has this right, as it provided by reference to a paragraph which does not currently exist within the CUSC. Although this has recently been discussed by the CUSC Governance Standing Group, which came to a view that the erroneous reference and therefore the ability for the panel to amendments should be removed, we consider the CUSC panel should be placed on the same footing as the BSC and UNC panel in being able to raise proposals to improve the administration of the code, rather than relying upon National Grid.

2.75. As the activities of the panels are largely set out in the relevant code modification rules, we consider that these changes could best be achieved through appropriate modifications being brought forward. We therefore intend to take this work forward through the CAWG process.

Code of practice

2.76. At present, there is no formal mechanism whereby best practice in a particular area of code and/or system administration can be recognised and widely adopted. In line with earlier discussions under the CAWG, our December document therefore suggested that this could be addressed through the introduction of a code of practice for code administrators.

Respondents' Views

2.77. Whilst the majority of respondents were in favour of the concept of a code of practice, views differed on the status the code should have. There was a large degree of support for a voluntary code as a cost effective means of ensuring best practice is shared amongst code administrators. Those opposed to any form of code suggested that best practice could be achieved simply through a greater degree of

cooperation and discussion amongst code administrators. Only one respondent specifically insisted that the code must be binding rather than voluntary, stating that this was required in order to ensure conformity across codes processes. Others felt that the code of practice would hinder the flexibility of the code administrators if it was made binding.

2.78. The code panels were against the idea on the grounds either that it would be impractical or that the existing tripartite meetings between code administrators were sufficient.

Ofgem's view

2.79. Since the December document was published, the CAWG has produced an interim report which considered the issues surrounding the introduction of a Code of Practice for code administrators in some detail.

2.80. We have subsequently decided that the CAWG should be reconvened to continue working on the introduction of a Code of Practice, with an emphasis on promoting convergence in code change processes across the major commercial codes, including developing standard pro-forma code change documents, and improving the transparency of code modification documents e.g. introducing 'plain English' summaries.

2.81. In order to progress the development of the Code of Practice we have asked the code administrators for the UNC, CUSC and BSC to prepare a 'straw man' to present to the CAWG. We expect that this 'straw man' will be prepared so that the CAWG can reconvene in late autumn. Our initial view is that the Code of Practice should be voluntary; however, to the extent that the Code of Practice is ineffective in delivering a greater degree of convergence and consistency in code change practice we would consider moving to a binding document.

2.82. We intend to discuss the Code of Practice further in our response to the CAWG report and consultation which we will publish shortly.

Performance evaluation measures

2.83. As we noted in our December document, a key issue governing the code administrators relates to ensuring that there is adequate accountability over the quality and costs of service provision.

2.84. There are several aspects of our initial proposals that focus on quality of service including call in and send back, the publication of reasons for decisions and the 'critical friend' approach. We have also discussed the importance of having sufficiently defined and clear objectives governing a code administrator's performance on costs and quality of service.

2.85. In our December document we consulted on a further mechanism to deliver accountability for costs and quality of service, in the form of a 'performance scorecard'. We set out our initial view that some form of performance 'scorecard' may be the most appropriate way of introducing performance evaluation measures. Elements of code administrators' performance that could be included on the scorecard include cost efficiency, timeliness (processing of modifications), quality of reports and analysis, and level of industry satisfaction.

Respondents' views

2.86. The idea of introducing performance evaluations for code administrators through some form of scorecard received widespread support. However, a few respondents thought that such an approach would be ineffective or that it would lack 'teeth'.

Ofgem's views

2.87. As we have noted above, we consider that it is important for the code administrators to have a clear set of objectives. Where possible these objectives should be measurable and used to assess the performance of the code administrator.

2.88. We consider that a performance 'scorecard' approach should provide a transparent process for assessing and comparing the performance of code administrators and should assist in developing measurable performance indicators for each of the code administrators.

2.89. We have therefore included the development of a scorecard approach within our initial proposals. We discuss further how this approach might operate in practice in Chapter 3.

Small Participants, new entrants and consumer representatives

2.90. Chapter 6 of the December document explored ways in which the needs of small participants, new entrants and consumers might better be met. We raised concerns that at present the complexity and fragmentation of the code modification processes make it difficult for these types of parties to engage with the code governance arrangements in a meaningful way, particularly as they typically have fewer resources and less ability to influence change when compared to the incumbent energy companies.

2.91. We indicated that if small participants and new entrants experience difficulties in committing resources to the codes then they are less likely to raise code changes, which may bring pro-competitive benefits. In setting out these concerns we are particularly conscious of the changing market landscape and the entry of smaller players including renewable and distributed generators as well as smaller suppliers. Our concerns also extend to consumers who can experience the same difficulties in engaging in complex code processes.

2.92. We therefore outlined our intention to explore ways to better meet the needs of small participants and new entrants as well as those representing consumers when they engage with the codes processes. Specifically, we said that we would consider whether:

- there should be some requirement on code administrators and panels to consider the needs of small participants and others in the context of the administration of the codes modification processes; and/or
- whether there are particular types of funding arrangements, e.g. a central advocacy fund, which could be established and funded by industry participants to assist in meeting these needs. Small participants and others would be able to draw upon such resources to allow them to take a fuller part in the codes change workgroups and also allow them to develop their own modification proposals.

2.93. We suggested four main approaches that could be taken to improve the situation, as follows:

Option 1: Status quo 'plus' - relatively minor adjustments to the current processes, including changes to code panel structures – including introducing voting rights for Consumer Focus on the UNC panel.

Option 2: Establishing a separately funded and administered Advocacy Panel

Option 3: Ofgem's Consumer Challenge Group is used to engage in code change processes

Option 4: Introduce a duty on code administrators to advocate on behalf of small participants, new entrants and consumers

Respondents' views

2.94. No respondents were in favour of significant change in this area, as represented by options 2, 3 or 4. Respondents were generally silent on these issues or favoured a version of option 1. In particular, Consumer Focus stated that it supported improvements to the level of consumer representation on panels, but that the advocacy panel would create resource implications both for Consumer Focus if it were to administer the associated fund, and potentially for smaller parties in applying for funds. A number of other respondents were in favour of consumer representation across the major codes. Some respondents were in favour of extending representation to small users, but others were against on the grounds that this would give small users disproportionate influence.

2.95. In relation to the UNC panel, some respondents commented that the current representation on the panel is equally split between transporters and shippers (five each), such that an additional consumer or small participant representative might, on

occasion, have significant influence. In particular some respondents were concerned that given the voting structure on the UNC, the inclusion of Consumer Focus voting would effectively grant it with a casting vote over many issues that might not affect consumers.

Ofgem's view

2.96. Given the lack of support for the idea of a separate advocacy panel and the improvements that can be made to small party consumer representation through lower cost initiatives, we do not intend to progress this proposal. We also recognise that Consumer Focus has an important role to play in engaging in codes processes and is starting to expand its role in this area, albeit largely confined to panel representation rather than work group engagement.

2.97. Similarly, whilst we consider there may be an important role for the Ofgem Consumer Challenge group in many of the issues that are facing the industry, including those which may potentially be addressed through a Major Policy Review, we do not consider that it would be practical for this group to engage on anything other than high profile and strategic modification proposals.

2.98. However, Ofgem remains concerned by the difficulties experienced by small participants and consumer interests in engaging in the codes process. These concerns were reinforced by a number of responses to our December document. For example one respondent has noted that the code change arrangements are skewed in favour of the incumbents. Other respondents have made similar points emphasising the difficulties for resource constrained smaller players who are restricted in their ability to engage compared to larger players who can employ larger teams of parties on codes issues.

2.99. We therefore remain of the view that action is required in this area and that code administrators are best placed to provide assistance to smaller parties and consumer interests.

2.100. Our initial proposals are therefore to **place a duty on code administrators to assist small participants and consumer interests** in participating in the code change process. This duty is discussed further in Chapter 3.

2.101. A further issue raised by the December document relates to panel voting and whether specific voting rights should be allocated to small participants (and Consumer Focus, in the case of the UNC).

2.102. Having considered respondents views we do not consider that creating dedicated panel seats with voting rights would be the most effective means of delivering significant benefits to smaller participants. We recognise that the resource implications required to fulfil such a role would be counter-productive to our aim of allowing smaller parties to gain maximum value from their potentially limited engagement in the process, particularly as not all proposals will directly impact smaller participants. Instead, we have outlined proposals in Chapter 3 to require

code administrators to proactively engage smaller participants where a proposal does have a direct relevance to them, rather than relying on the more usual blanket communication methods.

2.103. The role of consumer representatives in the GB industry codes is clearer and more explicit than for small participants, taking the form of membership of some of the code panels and also the right to raise change proposals under some of the codes. For instance, from 1 October 2008, Consumer Focus has had the right to appoint up to two BSC panel members and one CUSC panel member, in each case with full voting rights. Consumer Focus also has the right to appoint up to two members of the UNC panel but without voting rights. Other industry codes (DCUSA, iGT UNC, MRA, SPAA) allow Consumer Focus to attend panel meetings with the right to speak but not vote. Consumer Focus has an explicit right to raise change proposals under the following codes: the BSC, the CUSC, the DCUSA and the SPAA. It is also designated as a 'third party' by the Authority for the purpose of raising change proposals (relating to the table of operational and market data) under the UNC and the iGT UNC.

2.104. There are benefits arising from consumer representation on the code panels and through their ability to raise change proposals.¹¹ Panel membership allows those representatives to express views on issues arising under the relevant codes at panel proceedings. Where there are also voting rights attached to panel membership, the representative has the opportunity to influence the panel's recommendations to the Authority on change proposals, some or all of which may have an ultimate impact on consumers.

2.105. **Whilst Consumer Focus has the ability to vote and raise modifications under CUSC and BSC, we are concerned that equivalent rights do not exist under the UNC.** As such, we consider that the degree of consumer representation on each of the three main codes should be commensurate and therefore, that a consumer body such as Consumer Focus should have voting rights on the UNC panel. This is considered further in Chapter 3.

¹¹ Energywatch (the precursor of Consumer Focus) raised three modifications: one to the BSC and two to the UNC.

3. Further proposals

Chapter Summary

This chapter sets out each of the initiatives that we are now proposing to take forward. In many respects these represent a lighter touch than those contained within the December 2008 document, and do not require fundamental change to either the structural or funding arrangements.

3.1. In this chapter we set out in more detail our initial proposals for the role of code administrators and on small participant/consumer initiatives. We have also set out, for each particular initiative, an updated impact assessment.

Critical friend role for code administrators

Definition of a 'critical friend'

3.2. In the December consultation, we explained that, at a high level, we saw the role of a critical friend as that of a 'devil's advocate', testing the appropriateness of the analysis that is being contemplated and the strength of the conclusions that can be drawn from it. We believe that such a role encompasses two separate sets of activities: those that code administrators are expected to undertake in respect of all modifications (primary activities) and those they would only undertake when asked to do so (secondary activities) in response to requests from small market participants or consumer representatives.

3.3. We would welcome views on what these two classes of activities should encompass. At a minimum, we consider that the primary activities should include providing input into the terms of reference set by the panel, the working group's analysis and the panel members' conclusions. For example, we would expect a critical friend to be able to judge if Ofgem is likely to reject a modification due to a lack of analytical support and seek to prevent this occurring. If necessary, this might involve alerting the panel chair to the emerging risk so that the panel could take action to deal with them, perhaps by amending the terms of reference of the modification group. UNC modification 88¹² is a good example of a modification where a code administrator acting as a critical friend should have been able to prevent the situation being reached where Ofgem had to reject the modification due to a lack of relevant analysis.

¹² This modification was discussed in the 'Critique of the Industry Codes Governance Arrangements' produced by The Brattle Group and Simmons and Simmons for Ofgem in June 2008, see: www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/20080612%20Codes%20governance%20review%20final%20draft.pdf

3.4. As suggested by the CAWG, a 'critical friend' should ensure that: unsubstantiated assumptions or assertions do not go unchallenged, all arguments for and against a modification are adequately discussed at workgroup and panel level and reflected in the modification documents, and highlight any previous discussions or decisions that may be relevant to the modification being considered.

3.5. We also consider that a primary activity of a critical friend would be to assess modification proposals to determine whether they were likely to have a significant impact on smaller participants and/or consumers and, if so, to alert suitable representative organisations of this fact. Finally, we would expect a critical friend to alert other code administrators when a proposed modification was likely to have consequential effects for other codes (either directly or indirectly).

3.6. It is more difficult to define the scope of secondary activities for a critical friend since by definition they are less routine in nature and would only be undertaken when a request to do so is received from a small participant/consumer interest.

3.7. However, we envisage that they might include providing assistance to smaller participants/consumer representatives (where applicable) with the drafting of modification proposals (particularly with regard to legal text), and providing small participants/consumer representatives with clarifications as to the operation of part of the relevant code. In addition, the 'critical friend' might also ensure that the views of smaller market participants and consumers are both heard and effectively debated at work-group and panel meetings.

3.8. A number of respondents commented that Elexon, the Joint Office and National Grid already carry out many of these activities. We recognise that some efforts are made to differing extents to involve small participants in code debates. For example, some code administrators will actively follow up with small market participants to seek their input on modification proposals.

3.9. However, we are also concerned that more needs to be done to ensure that all sides of the argument on code modifications are properly debated, clearly articulated and assessed, and that small participants do not face particular disadvantages in engaging in the codes process. We therefore believe that there would be benefits in formalising the role that code administrators are expected to undertake to a greater extent than is currently the case.

3.10. We consider that the 'critical friend' role could be formally embedded and described within each of the relevant codes (namely, CUSC, UNC and BSC). For example, the activities that would be captured within the 'critical friend' role could be set out within the formal objectives of each code administrator. While in the case of the BSC these are set out in the code itself, the UNC refers only to the activities of the transporters rather than referring directly to the Joint Office. In addition to suitable code modifications this may therefore require changes to the Joint Governance Agreement for the UNC. Alternatively, Ofgem could progress licence modifications that set out detailed quality assurance measures that are required of code administrators, incorporating the attributes of the 'critical friend' approach.

3.11. We would welcome views:

- 1) Which activities should be considered within scope of the 'critical friend' approach? and
- 2) What is the appropriate mechanism to introduce the 'critical friend' approach?

Updated impact assessment

3.12. In the December document, we argued that introducing a 'critical friend' role should help to provide **rigorous and high quality analysis** of the case for and against code changes and provide **cost and efficiency** benefits, which are two of the main Review Objectives. We also suggested that improved analysis should also enable swifter decision making by Ofgem and thus enable modifications that deliver benefits to be implemented more promptly with consequential benefits for consumers. The introduction of a 'critical friend' approach as outlined above should also provide transparency benefits by ensuring that costs and benefits of modification proposals are properly articulated. We also expect that increased transparency should also facilitate engagement in the codes process, particularly from small participants. This should help to promote competition. We therefore continue to believe that introducing the 'critical friend' role should deliver important benefits.

3.13. In terms of costs, we suggested that there might be a need for each of the major commercial code administrators to hire an additional 0.75 - 1.00 full time equivalent ('FTE') employees, at a cost of £112.5k to £150k across the three main codes. Set against these costs, we considered that there should also be some offsetting reductions in the resources that Ofgem has to devote to code modifications. We estimate that this might be of the order of one FTE across all three major commercial codes. On this basis, from a purely quantitative perspective and not taking account of the important qualitative benefits we have set out above, we arrived at a net cost for the introduction of the critical friend role ranging from £62.5k to £100k per annum.

3.14. We received a response from the CUSC amendments panel which has outlined the costs of enhancing the code administration arrangements for the CUSC to be commensurate with those of the BSC and UNC. The costs included an additional 4-7 FTEs. It is unclear whether this calculation relates to a critical friend or active secretariat approach or what other elements of Ofgem's proposals are reflected in this calculation. Ofgem does not consider that the introduction of a critical friend approach or indeed the proposed obligations to assist small participants and consumer representatives would require significant additional recruitment in the range of 4-7 FTEs.

Obligations to assist small participants and consumer groups

3.15. As we have noted above in Chapter 2, in addition to the new 'critical friend' role we propose for code administrators and the Code of Practice discussed below, we also propose that code administrators should have a new obligation to assist small participants and consumer groups. We consider that this duty would help to ensure that the views of small participants and consumers are effectively captured and represented in the code change process. In particular, it would oblige code administrators to actively consider introducing measures that would facilitate small participant and consumer engagement and representation.

3.16. A new obligation to assist could be discharged by code administrators in a number of ways, including by:

- contacting relevant small participant/consumer representatives when a proposal raises issues that may impact on their group;
- helping small participant/consumer representatives effectively frame and develop modification proposals;
- ensuring that small participant/consumer representatives viewpoints can be articulated and debated at workgroup and panel meetings and that other workgroup members or panellists do not seek to stifle or prevent such debate;
- holding remote rather than 'live' meetings if this is more convenient for them;
- better scheduling of meetings that enable small participants to obtain updates on all code modifications at one meeting
- raising codes issues that are relevant to small participants at appropriate industry meetings, for example at Ofgem's Demand Side Working Group;
- establishing web-based forums and improving websites to provide easy access to information on code modifications. We note that Elexon has recently established a web-based forum and we will be interested to see the responses to this initiative; and
- ensuring that the views of small participants/consumer representatives are effectively articulated in workgroup and code modification reports and that impacts on small participants/consumers are specifically described.

3.17. To the extent such a new obligation is introduced, there are some important issues to consider. First, in order to be able to discharge a licence duty of this nature, code administrators will need to understand what constitutes a small participant. This is discussed further below. In addition, it is also important to consider whether the obligation should be a 'reasonable endeavours' obligation, recognising that there are costs associated with code administrators assisting small participants/consumer representatives and that any actions that are taken should be proportionate to the costs of doing so.

3.18. For example, as we noted in our December document a code administrator may make considerable efforts to elicit views on issues from small participants without any response. As such, it might be appropriate to ensure that any obligation is bounded by a reasonable endeavours principle.

3.19. Further, there is a question as to whether a separate licence/code obligation which creates a general obligation is necessary and whether the issues regarding small participant engagement can be effectively captured through the Code of Practice or the 'critical friend' approach.

3.20. We would welcome views:

3) Should a specific obligation be placed upon code administrators to assist smaller participants and consumer representatives?

3.21. As noted above, if a new duty on code administrators is created then it will be important to establish an agreed definition of small participant. The December document set out some proposed definitions of small participant. Few respondents commented on the definitions. One respondent commented that the definition would need to exclude those businesses which, whilst ostensibly small, may be owned by a larger parent company that would not itself fall under such a definition. Another respondent commented that the definition was too narrow and has been set at a level that would only capture micro businesses.

3.22. Whilst we remain of the view that these definitions provide a useful benchmark for generation licensees, we are concerned that the definitions for suppliers potentially exclude many of the small suppliers currently in the market who do not form part of the 'big 6'¹³. We note that the SPAA distinguishes between large and small suppliers, and between large and small Gas Transporters on the basis of whether they supply, or as the case may be are connected to, more or less than one million supply points.

3.23. We have therefore proposed an amendment to the definition which covers small suppliers and shippers, drawing upon the SPAA approach. In particular we propose to utilise the 'customer number' based threshold for defining small suppliers and gas shippers. Under this approach a small participant would include any gas or electricity supplier with less than 1 million consumers. We have not proposed any changes to the definition of a small generator or a small network and would invite comments and further discussion in order to identify a suitable threshold.

3.24. In the context of gas and electricity supply, we note that all of the 'big 6' suppliers are significantly above this one million supply point threshold, while all

¹³ Centrica; Scottish and Southern Energy; Scottish Power; E.on UK; EdF Energy and RWE Npower.

other suppliers are significantly below it. We therefore do not consider there would be any issue of threshold crossing in the foreseeable future. We also consider that this will broadly capture the parties who we envisage may legitimately require assistance, while excluding only those who manifestly should not.

3.25. Whilst we acknowledge that there are some very significant organisations which fall into the sub-one million supply point category, particularly those focused on the industrial and commercial sector, we also consider that they may have a relatively small team of individuals dealing with UK gas and electricity regulatory and code issues. We therefore do not believe that it would be appropriate to exclude parties from the small participant definition merely because they have a larger parent company either in the energy sector or any other sector.

3.26. We would welcome views:

4) For the purposes of identifying those who will be offered greater assistance by the code administrator, what is the appropriate threshold between small and large participants for each category of party?

Updated impact assessment

3.27. In the December document, we said that an obligation on the three main code administrators to assist consumer representatives and small participants might require an additional FTE for each code, at a cost of perhaps £150k/yr across the three main codes. However, we also recognise that there is a large degree of overlap between this and the role of the critical friend.

3.28. In terms of qualitative benefits we consider that a duty on code administrators to assist small participants and consumer representatives would provide **transparency, accessibility and inclusivity benefits**. In particular it would help to ensure that small participants and consumer representatives can engage effectively in the code change process. For example, it should assist these parties in understanding the consequences of modifications and should help to ensure that they can contribute to debates on these modifications.

3.29. The proposals should also help small participants in developing code modifications of their own. Ultimately we consider that this change is consistent with the objectives of the governance review and should indirectly facilitate competition. For example, as we noted in our December document, the proposals should help to generate pro-competitive policy and modification proposals with consequential benefits to competition. We also consider there will potentially be benefits to sustainable development, given that many smaller participants are renewable players. As we have not sought to quantify the impacts upon these separate, but potentially overlapping categories of participant we do not consider that there is a risk of double counting the benefits within the impact assessment.

Consumer representation on UNC panel

3.30. As we noted in Chapter 2, we believe that a consumer body should be granted voting rights on the UNC panel. As we have noted previously, the right to vote is an important mechanism for allowing a consumer voice to be heard and enabling it to influence debates on commercial issues that have impacts on consumers. The ability to vote makes active engagement in the modification process both more likely and more important.

3.31. We are encouraged that Consumer Focus has indicated in its response that, in seeking additional voting rights, it believes that this represents the most effective way for it to target its resources. Our initial view therefore is that the consumer body which is allocated a vote should be Consumer Focus and that it should be entitled to have at least one vote (although we note that there are 2 allocated Consumer Focus non-voting seats on the UNC panel). However, we think it important that the Authority has the option of designating more than one consumer body, or of transferring the designation. For example, a particular modification might engage the interests of commercial consumers more so than the interests of domestic consumers and, in this case, it might therefore be more appropriate for a representative/appointee of a commercial users' group rather than Consumer Focus to vote on the modification.

3.32. We agree with the concerns of respondents that in some circumstances the creation of a consumer vote on the UNC panel may place Consumer Focus or the relevant consumer body in a unique position with a balance of power on modifications where the panel recommendation splits evenly between transporter and shipper interests. We consider that this is likely to occur on only a limited number of occasions and we consider that having a voting consumer representative will place more emphasis and accountability on industry participants to effectively articulate the merits of the arguments in favour of, or against, a proposal like any other panel member. The consumer representative would also be able to consider proposals from the perspective of the impact on consumers, who ultimately pay the costs associated with the operation of the gas trading arrangements.

3.33. We note that the UNC panel's structure would change if there is a voting consumer representative and that the change would require a modification to the current UNC rules. We recognise that the introduction of a consumer vote will have an important effect on the UNC panel voting structures and would urge UNC participants to give consideration to how this might be achieved in practice.

3.34. Our proposals to have Authority appointed independent panel chairs on CUSC and UNC would also have implications for the voting structures on each panel, as it is proposed that each chair would also have a casting vote.

3.35. We would urge UNC participants to also consider the ways and means that a consumer vote could be introduced, noting that we are also proposing that the new independent chair hold a voting position.

3.36. We would welcome views:

- 5) **Is it appropriate to modify the Gas Transporters licence in order to provide voting member status to consumer representatives on the UNC? and**
- 6) **Are there any other bodies in addition to Consumer Focus which the Authority should consider as potential consumer representatives on the UNC?**

Updated impact assessment

3.37. We consider that the creation of consumer voting rights on the UNC panel will help to ensure that consumer impacts on modification proposals can be discussed and evaluated in advance of a modification proposal being submitted to the Authority for decision. A voting consumer representative should help to ensure that consumer impacts are discussed. This should facilitate **transparency** and **robust and rigorous analysis** of code modification proposals. In addition, we consider that the introduction of a voting consumer representative may have advantages in relation to our proposals for self governance and may assist a panel in determining whether a modification has any consumer impacts.

Independent panel chairs – CUSC and UNC panel

3.38. As noted in Chapter 2, we consider that an independent chair (vested with certain voting rights on code modifications) would provide a degree of independent oversight of code administrators, without requiring the wholesale structural reforms that would be required by a board or company structure. As the BSC already has an independent chair, the codes that would be impacted by this proposal would be the CUSC and the UNC.

3.39. The chair of the BSC is currently appointed by the Authority, under the terms of the BSC. We consider that it would be appropriate to extend this arrangement to the UNC and CUSC.

3.40. At present, the CUSC and UNC chairmen do not have voting rights although the BSC chairman has a casting vote¹⁴. With a move to independent chairs, it would seem appropriate for the CUSC and UNC chairs to similarly be granted rights with respect to a casting vote. More generally, we consider that providing independent panel chairs with voting rights is an important mechanism for providing them with the authority to carry out their role effectively. Indeed, we consider that the

¹⁴ BSC Section B 4.4.4

introduction of independent panel chairs with effective powers is likely to be an important element in helping to ensure that many of the other initiatives proposed in this document are delivered effectively by the relevant code panels and code administrators.

3.41. We accept that there may be a difficult balance between the necessary experience of the chair and perceptions of their impartiality. This is particularly likely to be the case given the part-time nature of the role. This may mean that candidates may well have other interests in the industry, for instance acting as a consultant or non-executive board member. However, this could be accommodated provided that the chair is required to disclose any potentially conflicting interests that they may have, and potentially having mechanism by which they could stand down or abstain from voting on any matters where there may be a conflict, possibly passing their casting vote to the deputy chair. We would also note that in the case of the CUSC and the BSC, several of the existing panel members are employees of major energy companies, though they are required to act independently, notwithstanding their employment situation.

3.42. In practical terms, we propose licence modifications to National Grid's licence (in the case of CUSC) and to the gas transporters' licences for National Grid and the gas distribution networks (in the case of the UNC) to give effect to these proposals. These licence modifications would, where necessary also prescribe changes to the relevant codes. In the case of the UNC we invite views on whether changes are necessary to the JGAA to give effect to these proposals.

3.43. In terms of funding, we would propose that the costs of the independent chairs are recovered through the price controlled allowance for administering the codes.

3.44. We would welcome views:

7) Do you agree that the Authority should appoint the chairs of the UNC and CUSC panel in addition to the BSC?

8) Should such an appointment be made only at the end of the current chairs ordinary tenure?

9) How should the salaries of the independent chairs be funded? and

10) What is the appropriate mechanism by which these proposals can be introduced?

3.45. Updated impact assessment

3.46. In the impact assessment included in the December document, we noted that the costs of introducing independent chair should be small. There would be some limited set-up costs relating to the code or licence modifications (and potentially modifications to the Joint Governance Arrangements Agreement in the case of the

UNC) required to change the current governance structures and some recruitment costs. Our view was that there should be no net on-going costs because the costs of the new chair are likely to be similar to the costs of the existing chair. However, it may be that in the case of the UNC, the separation of a chair of panel role from the CEO of the Joint Office may mean there are ongoing incremental costs.

3.47. In terms of benefits, we consider that having independent chairs for the UNC and CUSC should help ensure that code modifications **administered in an independent, transparent and objective manner** and be more likely to **promote inclusive, accessible and effective consultation**.

Call in and send back powers

3.48. In Chapter 2 we set out our intention to introduce 'call in' and 'send back' and set out a discussion on how these powers could operate. These powers would need to be delivered through licence changes, and potentially consequential code changes. We would propose that consistent with our other proposals these changes are restricted in scope to the BSC, UNC and CUSC. In practical terms, the 'call-in' powers could enable the Authority to:

- issue directions/instructions to code panels on timetables;
- issue directions/instructions on analysis that must be undertaken on a proposal *before it is submitted to the Authority*;
- issue directions to the panel to revise the terms of reference for the assessment of the modification; and
- require a panel to report to the Authority on the progress of a modification and the analysis being undertaken on the proposal.

3.49. In practical terms the 'send back' powers would enable the Authority to send back a final modification or amendment report to the panel in circumstances where the Authority considers that the analysis contained within the report is deficient and requires further work to be undertaken. We have not at this stage suggested licence drafting for the creation of 'call in' and 'send back' powers as we consider that they could more appropriately be set out in the relevant codes. However, in the event that suitable modification proposals are not forthcoming and subject to the outcome of this consultation, we may suggest licence modifications as part of our final proposals.

3.50. We would welcome views:

11) Do you consider it necessary to include the powers to 'call in' and 'send back' modification proposals within the relevant licences?

Updated impact assessment

3.51. In the December document, we noted that these options should help to ensure **rigorous and high quality analysis** as well as increasing **cost effectiveness** within the codes modification process. We would not expect to have to use these

powers frequently and would only do so where we considered it was reasonable to make such a direction. If anything, the proposals are likely to reduce costs overall because there should be less chance that work will have to be duplicated. Nothing came out of the consultation that would lead us to change our views.

Panels to provide reasons for decisions

3.52. Whilst the practice for providing recommendations is similar across each of the three main codes, they do differ in the extent to which they make explicit reference to the relevant objectives, the details into which they go, and the degree to which comments are attributable to individual panel members. We consider that the panel recommendation is an integral part of the modifications process and that panel members should reasonably be transparent, and to the extent they purport to represent the views of others, accountable for their voting decisions.

3.53. As we have indicated in Chapter 2, we consider that panel members should provide reasons for their recommendations and that these reasons should be expressed in relation to the relevant objectives of the code in question. The reasons should also appear in the final modification or amendment report. It may also be appropriate for each panel member to place on record their views, not just on which relevant objectives they consider the proposal does or does not better facilitate, but a short explanation of why.

3.54. It is also common practice under the BSC for the panel to provide an initial view which is included within the report which is issued for consultation. This practice could be extended to the CUSC and the UNC relatively easily where the proposal has first been the subject of development and a workgroup report; it may not be practicable where the panel concedes to a proposer's request for the proposal to be issued straight to consultation. We consider there may be value in adopting the BSC practice in other codes to the extent that it may shape the subsequent responses, both in terms of highlighting the implications of the proposal against each of the relevant objectives.

3.55. We consider this may have additional benefits to the extent that the panel members may be basing their individual recommendation on facts or assumptions which, with the benefit of consultation and further evidence gathering, may be proven to be spurious. We therefore consider it is helpful for panel members to have opportunity to revise their initial view having regard to responses.

3.56. We therefore propose to modify the licences, explicitly aligning the requirements under each of the three main codes. Such a licence modification would obligate the relevant code owner to raise the necessary modification proposal. We recognise that in some cases these modifications may simply reflect what already happens in practice, where panel members already provide a detailed rationale, though the modifications will ensure they continue to do so rather than relying upon custom and practice, which may vary as panel membership changes over time.

3.57. We would welcome views:

12) Do you consider that a licence modification requiring more explicit provision of reasons for recommendations is appropriate?

Updated impact assessment

3.58. We do not envisage there being any significant costs, beyond the additional time it will take to express and record reasons for each panel recommendation. We remain of the view that a requirement to publish reasons for recommendations would enhance **transparency** and should help to ensure that **rigorous and high quality analysis** is undertaken on the relevant code modification proposal.

Performance scorecards for Code Administrators

3.59. As set out in Chapter 2, we consider that it is important for the code administrators to have a clear set of objectives and be consistently assessed against those objectives. We indicated that some form of performance 'scorecard' would be the most appropriate way of introducing performance evaluation measures. Such an approach would enable Ofgem to compare, where possible, the performance of the code administrators across a range of areas. In turn, this could help to provide incentives for code administrators to improve their performance. We would propose that Ofgem undertake the comparative scorecard evaluation once every two years. The evaluation would capture CUSC, UNC and BSC, but could usefully be extended to include those codes which are managed through service contracts such as DCUSA.

3.60. In our December document we gave an example of the scorecard providing qualitative assessments e.g. a rating between 1 and 5, of each code administrator for a number of different dimensions rather than a direct quantitative comparison such as the average cost per modification. Elements of code administrators' performance that could be included on the scorecard include:

- cost efficiency;
- timeliness (processing of modifications);
- level of industry satisfaction over costs and quality of service; and
- quality of reports and analysis.

3.61. We note that Elexon regularly undertakes customer surveys¹⁵, and that the Joint Office has in the past undertaken such an exercise, though not on a regular basis. Whilst the findings of such a survey can again be subjective, potentially skewed by the users' most recent experience, or perhaps their perceptions of a

¹⁵www.elexon.co.uk/documents/Publications/CustomerSatisfactionSurvey/ELEXON_Customer_Survey_2009_Results.pdf

particular modification rather than as a whole, we nonetheless consider that going forward such surveys could have an important role to play in informing a scorecard approach. This may also be important for any initiatives aimed at consumer representatives or smaller parties, who may not otherwise have an opportunity to provide feedback through panel meetings and other forums.

3.62. If a Code of Practice for code administrators were introduced, then a further dimension for the scorecard approach might be adherence to the principles that it contained. Indeed, the introduction of a Code of Practice with consistent standards for code administrators should help to facilitate effective comparisons on performance across the administrators.

3.63. A further factor that may help to inform a comparative performance evaluation is whether the relevant code administrators should be required, either through a licence condition or a stipulation in the relevant code, to attain and thereafter maintain ISO 9001 accreditation. ISO 9001 is the internationally recognised standard for an organisation's internal Quality Management. An organisation's 'Quality Management' refers to an organisation's actions to ensure that its products or services satisfy its customers' quality requirements and complies with any regulations applicable to those products or services. Our understanding is that the cost of obtaining ISO 9001 accreditation varies from organisation to organisation, but may be in the region of¹⁶ £1k to £3k.

3.64. We would welcome views:

13) Do you consider that a regular scorecard evaluation of the code administrators' conducted by Ofgem would be of value, particularly in influencing the behaviour of the code administrators?

14) Do you consider that code administrators' should be required to obtain and maintain ISO9001 accreditation for their processes?

Code of Practice

3.65. As we have noted in Chapter 2, we consider that a code administrators' Code of Practice should be developed. As we have noted previously, we have requested that the administrators of the CUSC, BSC and UNC prepare a 'straw-man' Code of Practice and that the CAWG be reconvened to review this document. We intend to discuss the Code of Practice further in our response to the CAWG report.

¹⁶ Quote obtained from the British Accreditation Bureau: www.british-accreditation.co.uk/ISO-9000-certification-services.htm?gclid=CP6D-Z_Wp5sCFVka4wodeBiopw

Code Governance Review – Role of code administrators and small participant/consumer initiatives – next steps

July 2009

Appendices

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 18 September 2009 and should be sent to:

Jon Dixon
Head of Industry Codes & Licensing
3rd Floor, Ofgem, 9 Millbank, London, SW1P 3GE
020 7901 7454
industrycodes@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Any questions on this document should, in the first instance, be directed to:

Jonathan Dixon
Head of Industry Codes & Licensing
3rd Floor, Ofgem, 9 Millbank, London, SW1P 3GE
020 7901 7354
Jonathan.dixon@ofgem.gov.uk

CHAPTER: Three

Question 1: Which activities should be considered within scope of the 'critical friend' approach?

Question 2: What is the appropriate mechanism to introduce the 'critical friend' approach?

Question 3: Should a specific obligation be placed upon code administrators to assist smaller participants and consumer representatives?

Question 4: For the purposes of identifying those who will be offered greater assistance by the code administrator, what is the appropriate threshold between small and large participants for each category of party?

Question 5: Is it appropriate to modify the Gas Transporters licence in order to provide voting member status to consumer representatives on the UNC?

Question 6: Are there any other bodies in addition to Consumer Focus which the Authority should consider as potential consumer representatives on the UNC?

Question 7: Do you agree that the Authority should appoint the chairs of the UNC and CUSC panel in addition to the BSC?

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Question 13: Do you consider that a regular scorecard evaluation of the code administrators' conducted by Ofgem would be of value, particularly in influencing the behaviour of the code administrators?

Question 14: Do you consider that code administrators' should be required to obtain and maintain ISO9001 accreditation for their processes?

Appendix 2 – Respondents to the December 2008 consultation

This section lists the organisations which submitted a response to the December document. Non-confidential responses have been posted on the Ofgem website.

- The Association of Electricity Producers (AEP)
- Arthur Probert
- The Balancing and Settlement Code (BSC) panel
- The British Wind Energy Association (BWEA)
- Centrica
- Consumer Focus
- Contract Natural Gas
- Cornwall Energy Associates
- Corona Energy
- The Connection and Use of System Code (CUSC) panel
- The Distribution Code review panel
- Drax
- E.on
- Electricity North West Ltd
- Elexon
- The Energy Retail Association (ERA)
- Exxon Mobil
- The Gas Forum
- Good Energy
- Haven Power
- IPM Energy Ltd
- The Joint Office of Gas Transporters
- The Master Registration Agreement Executive Committee
- National Grid
- Northern Gas Networks
- RWE Npower
- Scottish and Southern Energy
- Scottish Power
- Total Gas and Power
- The Uniform Network Code panel
- Welsh Power
- Xoserve

Appendix 3 – Revised Initial Impact Assessment

Summary

This Appendix builds upon the initial assessment published as part of the December document, taking into account feedback received from respondents. Those responses are set out below. The impact assessment has also been revised to reflect the narrower scope of the proposals contained in this initial proposals document.

Background

3.66. The potential changes to the responsibilities, governance and funding of code administrators described above are essentially a menu of possible options and do not form a single set of proposals. They also need to be considered in the context of the proposals for changing in the way in which modification proposals are processed including the possible new routes of major policy reviews and self-governance. For all of these reasons, it is not possible to produce a single impact assessment.

3.67. We have sought to make a provisional assessment of the various proposals on the basis of their potential to make the operation of the industry codes more efficient and more inclusive, taking account of the Industry Codes Governance Review Objectives. However, assigning a quantitative benefit to such outcomes is generally extremely difficult and so most of the discussion that follows is focused on qualitative assessments.

Role of code administrator in code modifications

3.68. One set of potential changes discussed in this document relates to giving the code administrator more responsibility for the quality of the analysis carried out in assessing modifications, via either the 'critical friend' approach. This, in turn, should help to provide **rigorous and high quality analysis** of the case for and against code changes which is one of the main Review Objectives. Better analysis by the industry should enable industry participants and the panel to reach a more informed view of the advantages and disadvantages of modifications. This will be particularly important if some modifications are handled via a self-governance process. In addition, it should reduce the amount of additional analysis that Ofgem has to carry out when a modification comes to us for a decision and should also reduce the risk of Ofgem having to reject modifications that are submitted to it with deficient or inadequate analysis. We consider this would in turn reduce the potential for modification proposals to be re-raised and hence would provide **cost and efficiency** benefits. In addition, improved analysis should also enable swifter decision making by Ofgem. This should in turn enable modifications that deliver benefits to be implemented more promptly with consequential benefits for consumers and the industry.

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3.69. Of the two options put forward, it is clear that the 'active secretariat' would have more significant implications for code administrators than the 'critical friend' option. Our initial impact assessment stated our view that if the 'critical friend' approach were adopted the costs would be approximately half those associated with the 'active secretariat' option.

3.70. As noted above, there should also be some offsetting reductions in the resources that Ofgem has to devote to code modifications. We estimate that this might be of the order of 1 FTE across all three major commercial codes.

3.71. On this basis, from a purely quantitative perspective and not taking account of the important qualitative benefits we have set out above, we have estimated in the table below that the net costs of enhancing the role of code administrators to a "critical friend" in relation to modifications could be £62.5-100k/year.

3.72. We received a response from the CUSC amendments panel which has outlined the costs of enhancing the code administration arrangements for the CUSC to be commensurate with those of the BSC and UNC. The costs included an additional 4-7 FTEs. It is unclear whether this calculation relates to a critical friend or active secretariat approach or what other elements of Ofgem's proposals are reflected in this calculation. Ofgem does not consider that the introduction of a critical friend approach or indeed the proposed obligations to assist small participants and consumer representatives would require significant additional recruitment in the range of 4-7 FTEs.

	Min	Max
Code administrator costs for UNC, BSC and CUSC		
FTE equivalents required	2.25	3
FTE costs (£k/yr)	50.0	50.0
Annual costs (£k/yr)	112.5	150.0
Ofgem savings		
FTE equivalents required	1	
FTE costs (£k/yr)	50.0	
Net Costs (£/yr)	62.5	100.0

Appointment of independent panel chairmen

3.73. We are consulting on the proposal for independent chairmen of code administrators to be appointed by the Authority. Code or licence modifications (and potentially modifications to the Joint Governance Arrangements Agreement in the

case of the UNC) would have to be raised to change the current governance structures but these would be one-off costs associated with simple modifications. We expect that the costs of making these changes would be small.

3.74. If new chairs are to be appointed by Ofgem there would be some costs associated with the recruitment process, though these should be small. In principle, there should not be any net on-going costs because the costs of the new chairman are likely to be similar to the costs of the existing chairman, although this will in part depend on the role of the code administrator. We consider these costs would be offset by the benefits of increased independence and transparency, and potentially by saving in the scope of the chair's role.

'Call in' and 'send back' options

3.75. Under these proposals, as discussed in Chapter 5, Ofgem would be able to 'call in' and 'send back' modifications. In terms of costs, we do not consider that there should be any material costs associated with the 'call in' and 'send back' options. Indeed, we consider that the existence of these powers should help to incentivise industry and the code administrators to improve the quality and timeliness of their assessments, and as discussed in Chapter 5, should reduce the likelihood that a proposal is rejected by Ofgem (on the basis of deficient or inadequate analysis) and then re-raised. In summary, we consider that these options should help to ensure **rigorous and high quality analysis** as well as increasing **cost effectiveness** within the codes modification process.

Requiring panels to publish the reasoning behind their recommendations

3.76. We do not consider that there should be any material on-going costs associated with this requirement as it would simply be a matter of the code administrator collecting and recording the panel members' reasons for decision. In terms of benefits we consider that this proposal should help to ensure **rigorous and high quality analysis** by providing some discipline on panel members to explain their reasoning. We also consider that a requirement to publish reasons would enhance **transparency**.

3.77. There may be some costs in terms of amending codes and licences to introduce this requirement.

Allowing code panels to raise modifications

3.78. As we have noted in chapter 2 we are no longer proceeding with proposals to enable code administrators to raise code modification proposals directly. However, we consider that the ability to raise modification proposals should be extended to the UNC and CUSC panels. We consider that this would enhance the **flexibility of the modification arrangements** as panels would be able to address deficiencies which

hinder the efficient administration of the code arrangements and seek to correct them when they might otherwise not be addressed.

Introduction of a code of practice

3.79. A code of practice should enable all code administrators to be aware of, and adopt, best practice in the various roles they fulfil. Consequently, this should provide benefits in terms of more **transparent and easily understood processes** as well as promoting **inclusive and accessible** consultation processes, particularly for consumers and small market participants. As we have noted in chapter 3, a code of practice should also help to facilitate effective comparisons on performance across the BSC, CUSC and UNC administrators, potentially **promoting cost effectiveness and improved quality of service**.

3.80. There would, however, be both set up costs and on-going costs in managing the code of practice (and in enforcing the code of practice to the extent it was binding), since any such code should be viewed as a living document, being updated as circumstances change. Set up costs would be incurred by code administrators as well as industry participants and Ofgem in contributing to the content of the code of practice.

Performance evaluation measures

3.81. The benefits of introducing performance evaluation measures should be similar to those associated with introducing a code of practice since their purpose is to improve the way in which the various code administrators work. In other words, there should be benefits in terms of more **transparent and easily understood processes** and the **promotion of inclusive, accessible and effective consultation**. A key reason for considering the introduction of performance evaluation measures is that they should increase incentives on the code administrators to ensure that they act in an **independent and objective manner**. They should also promote the **provision of high quality analysis** of change proposals as well as **cost efficiencies**.

3.82. Our proposal is that a 'scorecard' should be produced for each code administrator once every two years. The evaluation would capture BSC, UNC and CUSC but could usefully be extended to include those codes which are managed through service contracts such as DCUSA. With 10 codes we expect the costs to Ofgem of undertaking a performance evaluation every two years might be approximately around £70,000.

Small participant, new entrant and consumer initiatives

3.83. All of the options that we have discussed are intended to **promote inclusive, accessible and effective consultation** for small participants, new entrants and consumers and to ensure that all interested parties are able fully to understand the code governance processes.

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3.84. In addition the promotion of effective representation of the views of small participants, new entrants and consumers could, if effectively implemented, improve policy making at the codes level and the assessment of code modification proposals with indirect benefits to consumers and/or competition.

Status quo 'plus'

3.85. We outlined three initiatives that could be pursued under this option. The first was to ensure that Consumer Focus could have a voting member on the panel of each of the codes. The second was for small participants to have designated representation on code panels. We have decided not to proceed with this aspect of our proposals for the reasons outlined above. The third was for code administrators to have obligations to engage with small participants, new entrants and consumer representatives at the same time as, but outside of, the modification group process.

3.86. The costs associated with the Consumer Focus panel membership option would relate primarily to higher staffing requirements at Consumer Focus associated with funding UNC panel participation (alongside CUSC and BSC). We anticipate that this would take up a proportion of a senior manager's role at cost of say £20k/year.

3.87. If code administrators were to be obliged to engage with small participants, new entrants and consumer representatives (e.g. through a form of reasonable endeavours obligation) through the modification group process, then it is likely that additional code administration staff would be required for this task. As an initial assessment, we assume that around 1 FTE would be required per code. If this requirement applied to the three major codes, then we anticipate the costs should be around £150k/yr.

3.88. As we have noted above in chapter 3, the introduction of such an obligation would help to ensure that small participants and consumer representatives can engage effectively in the code change process.

Impact on Consumers

3.89. We have assessed above, in general terms, the benefit and cost implications of the various options that we have set out in this document, having particular regard to the Review Objectives.

3.90. The key benefits to consumers associated with the options set out above are in two categories, namely:

- **The benefits to those consumers and consumer groups who engage directly in the modification process.** We have set these out above already, and they include transparency, accessibility, and inclusivity benefits. We also believe that to the extent that self governance is introduced, there are important benefits to consumers associated with being able to engage in and understand the modifications that are being considered through the industry code processes.

- **The benefits to consumers generally.** We consider that by helping small market participants and new entrants to engage in the codes process this should indirectly facilitate competition. In particular the changes set out in this document should help smaller participants and new entrants engage in, understand and influence the codes modification process. Ultimately, making the regulatory framework more transparent and accessible should benefit competition. In addition, there is also the possibility that the changes that have been proposed should help small participants and new entrants raise code modification proposals that provide benefits to consumers. Further, by improving the quality of analysis that is undertaken and the efficiencies of the code modification process, this should also indirectly ensure that modification decisions that benefit consumers are made faster than is currently the case.

3.91. It is important to note that many of the proposals would incur **costs** that would ultimately be borne by consumers. We consider that for the proposals we have set out in this document these costs are likely to be minimal. Indeed, as we have noted above, we are not proceeding with the more costly options such as the introduction of 'active secretariats', board structures or the creation of a customer advocacy panel.

3.92. We would welcome views from respondents on which proposals they believe are proportionate to the costs involved.

Impact on Competition

3.93. As we have discussed above in the section on consumer impacts, we consider that the improvements in the governance process that help facilitate engagement from small market participants and new entrants in the codes modification process. We consider that increased transparency in the code change process should help facilitate understanding of the regulatory arrangements. Many small participants and new entrants have limited resources compared to the larger incumbent energy businesses and therefore struggle to engage in reform in key policy areas. By helping small participants and new entrants to engage this should indirectly help to generate pro-competitive policy proposals, with consequential benefits to policy making and potentially benefits to competition.

Impact on Sustainable Development and Health and Safety

3.94. It is important to note that many of the smaller participants that struggle to engage in existing codes processes due to their complexity and resource intensive and piecemeal nature are smaller generators, often from the renewable sector (including distributed generation).

3.95. We consider that the introduction of policies to improve engagement and participation from small parties and new entrants such as renewable generators might provide consequential benefits in terms of policy development in the sustainable development area.

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Impact on Health and Safety

3.96. We do not foresee any impacts on Health and Safety as a result of these proposals.

Risks and Unintended Consequences

3.97. We consider that the key risk is that the changes proposed do not deliver their intended benefits and that consumer/small participant engagement does not increase as a result of any changes that are implemented.

3.98. A particular risk is that the roles and responsibilities of code administrators are expanded with minimal consequential benefits and, with industry participants incurring more costs in funding these responsibilities.

Appendix 4 – The Authority's Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002, the Energy Act 2004 and the Energy Act 2008, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.¹⁷

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly¹⁸.

1.4. The Authority's principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- The need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- The need to secure that all reasonable demands for electricity are met;
- The need to secure that licence holders are able to finance the activities which are the subject of obligations on them¹⁹;
- The need to contribute to the achievement of sustainable development; and

¹⁷ entitled “Gas Supply” and “Electricity Supply” respectively.

¹⁸ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

¹⁹ under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

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- The interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.²⁰

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- Promote efficiency and economy on the part of those licensed²¹ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- Protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- Secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- The effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- The principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- Certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation²² and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

²⁰ The Authority may have regard to other descriptions of consumers.

²¹ or persons authorised by exemptions to carry on any activity.

²² Council Regulation (EC) 1/2003

Appendix 5 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

Andrew MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk