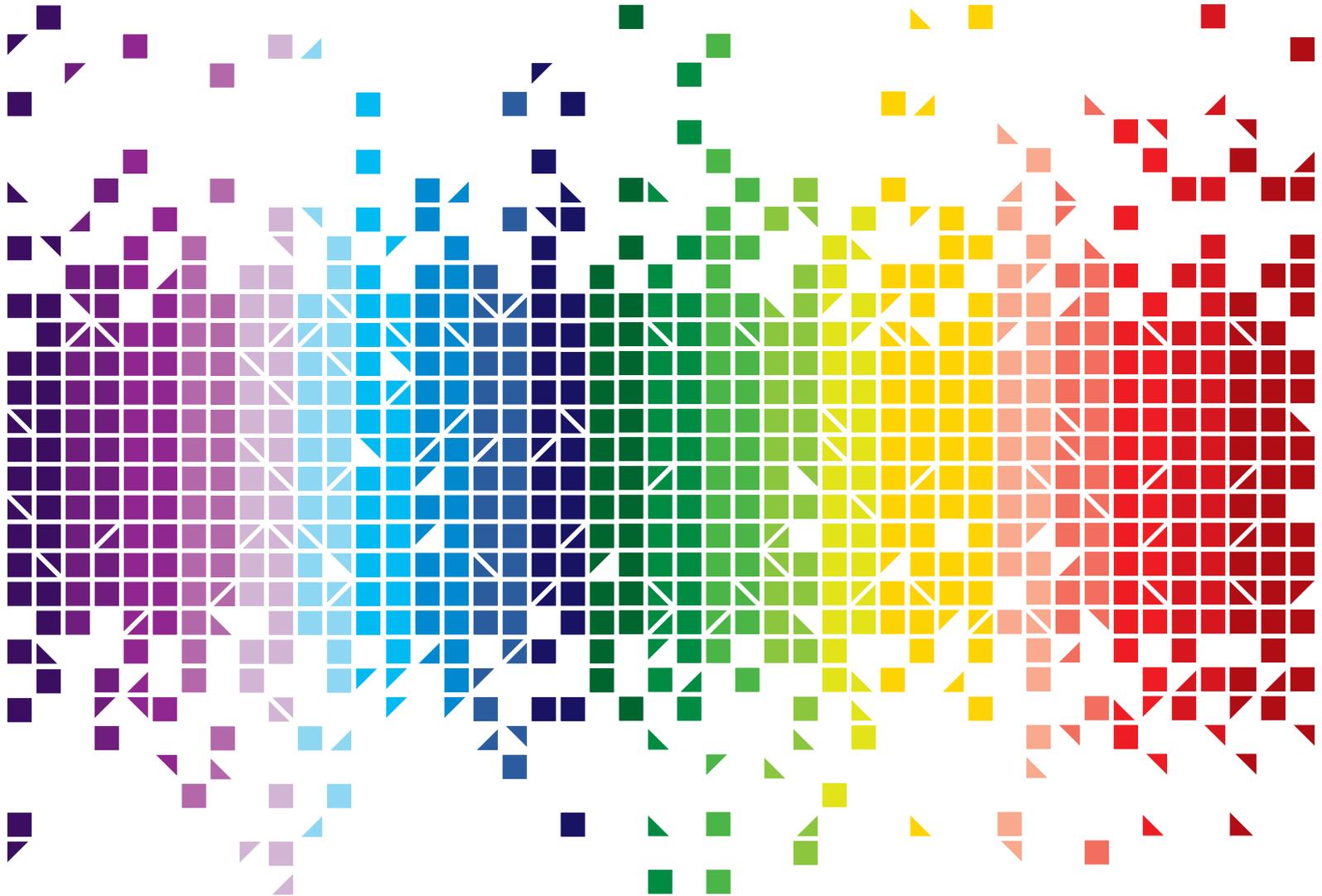


From Faster Switching to a Retail Energy Code

Simplifying Code Governance





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Introduction

In December 2015, Genserv published its thought leadership paper on code governance arrangements¹. Since that date, the CMA published its final report (24th June 2016) following its energy market investigation. With the possible exception of licensing of code administration, remedies were very much aligned with our thinking i.e. focusing on a Consultative Board², strategic oversight of change across the energy sector³, and greater transparency via a strategic plan.

10 years from now, whilst we cannot be exactly sure what the energy sector will look like, we can be certain it will be significantly different from today. Interconnected and renewable technology solutions, against a smart metering backdrop, will drive the coming of age of the prosumer (where the role of producer and consumer begins to blur and merge). Indeed, Ofgem have themselves recognised the challenge to explore emergent thinking on the types of energy sectoral changes and innovation we may see, under Ofgem's Future Insights Programme⁴.

On the immediate horizon for retail consumers are the smart meter roll out programme and Ofgem's Faster Switching Programme⁵. As we move into the Detailed Level Specification Phase (DLS) for faster switching, Ofgem is considering where to house the governance that will ultimately support faster switching (live in 2019). On 19th January 2017, Ofgem published its Request for Information (RFI) to help assess and cost the solution design options. This will lead to a consultation around August 2017.

There is a clear regulatory shift, away from an industry centric code governance approach and increasingly towards one that has a much greater consumer focus. This has implications not just for code governance, but also for how codes are shaped and structured and how they can best take account of a public interest agenda.

It is against the above backdrop, this paper sets out how the code consolidation challenge and how a Retail Energy Code (REC) could ultimately help support a more simplified code governance model, one that applies a consumer centric philosophy. We explain what it might look like, what the optimum path is for transition, and when it might be achieved.

1. Genserv, 27 January 2016, *Transforming energy Code Governance Arrangements*, <http://www.genserv.com/insights/thought-leadership-papers/transforming-code-governance-arrangements/>

2. CMA, 24th June 2016, *Energy Market Investigation, Decision in AECs and remedies*, p.21, section 20.13

3. CMA, 24th June 2016, *Energy Market Investigation, Decision in AECs and remedies*, p.21, section 20.13

4. <https://www.ofgem.gov.uk/publications-and-updates/ofgem-s-future-insights-series-overview-paper>

5. Ofgem, <https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/smarter-markets-programme/switching-programme>, accessed 3rd Jan 2017



The Code Consolidation Challenge

Industry codes have stood the test of time, and with perhaps just two key exceptions as highlighted by the CMA⁶, there is a great deal of evidence⁷ to support the claim they have actively underpinned the implementation of energy policy in line with the demands of energy market needs for over two decades. However, the reform agenda confronting the energy sector will be fundamentally more challenging as we step forward; not surprisingly, there is a growing realisation that reform is now necessary.

Energy market policy and reform is driving an unprecedented level of market change - even before the CMA formally announced its full package of energy market remedies. The market change context is eye watering: with the smart metering implementation programme introducing 53 million devices by the end of 2020 and faster switching measures striking at the heart of competitive interactions across the market (running into tens of millions of transactions every day). Add to that the transition to a low carbon economy, such as electric vehicles, new forms of storage, smarter networks, and now Brexit. Alongside this, the CMA has made a number of Orders⁸, including, the provision of access for Price Comparison Websites (PCWs) to central market data, the development of a disengaged customer database, and for the licencing of code administration and delivery bodies. The stage is consequently set for a programme of market transformation that, by any measure, is of gigantic proportions.

Contextualise this with a decreasing pool of energy market sector experts⁹, resources which help provide robust analysis and market design upon which market reforms are so dependent. Not surprisingly, market participants (whether large or small) already overwhelmed by the level of change, are now even more so.

Today's code structures have evolved over time, with no real overarching code governance strategy. Industry participants need to be party to, or comply with, many codes, even when the scope of what they deliver is discrete. Consider the challenges for a dual-fuel supplier who may need to be party to, or comply with the: Master Registration Agreement (MRA), Smart Energy Code (SEC), Distribution Connection and Use of System Agreement (DCUSA), Supply Point Administration Agreement (SPAA), Connection and Use of System Code (CUSC), Balancing and Settlement Code (BSC), Green Deal Arrangements Agreement (GDAA), Distribution Code, Grid Code etc. There are currently 11 central industry codes defined under CACoP¹⁰, and only one of them is already dual fuel enabled (the SEC).

Whilst the enormity of market reform already underway is not a consequence of the code governance framework, but rather driven by policy, regulatory and environmental reform, shifting towards a future code consolidated world will help reduce the engagement burden of market participants. Especially if that consolidation focuses on the functions (i.e. market related activities) that are better aligned with how organisations engage with energy markets and where the needs of consumers (the public interest angle), can be best managed. So, whilst code consolidation will not reduce the amount of change taking place, it can make it easier to deal with by driving more consistent change management practices, reduced code panels and working groups, consolidated budgetary and financial practices (to name a few).

Some stakeholders have argued this can be best achieved via a fundamental rewriting of the governance framework via a return to centralised government based institutions, others for consolidation at a code body level, and some for an organic shift under a competitively procured code governance framework.

6. CMA, 24th June 2016, *Energy Market Investigation, Final Report*, section 182, p.43, and section 9.546, p.587

7. In excess of 200 industry code changes are enacted every year based on Ofgem's CACoP performance reporting metrics

8. CMA, 14th December 2016, *Final Orders*, <https://www.gov.uk/cma-cases/energy-market-investigation>

9. UK Commissions for Employment and Skills, March 2015, *Evidence Report 90, Sector Insights: Skills and performance challenges in the energy sector*

10. Ofgem, *Code Administration Code of Practice*, <https://www.ofgem.gov.uk/licences-codes-and-standards/codes/industry-codes-work/code-administration-code-practice-cacop>



We agree with the organic shift simply because this minimises disruption of the existing energy reforms already underway and also because it avoids the tensions that arise where state controlled mechanisms can be influenced by politicised agendas, which can become too detached from the markets they would serve.

It would be better to drive a competitive code governance framework towards a strategic target model; one that allows code reform to gravitate towards a more efficient and coordinated code governance approach, without undermining the strategic market reform (such as smart metering) that is already well underway.



Creating the Right Code Governance Framework

We believe that the role of central codes, in terms of supporting innovation and facilitating industry-wide engagement and change, needs to evolve. Codes have grown organically from the first days of energy market competition back in 1996 and constitute to some extent at least, a ‘hotchpotch’ of codes that could be better optimised.

The homogeneous nature of gas and electricity products, coupled with the growth in new business models and convergent technologies (such as enabled under smarter homes¹¹), is driving a sea change towards bundled products and services for consumers, where traditional market boundaries become blurred. Even the very definition of an ‘energy consumer’ is now being challenged as they become active participants in an emergent energy future that allows them to produce their own energy and also sell it back to their energy services company – the age of the energy prosumer is amongst us.

Fundamentally, central codes exist to ensure the market processes and systems can talk to each other in order to support a wide range of market actors that need to collaborate such that market interoperability is effective and efficient. But codes also provide rights and obligations for those participating within competitive markets, whether this is simply a right when to expect a particular market action takes place or an obligation to behave in a certain manner (e.g. in case of code party disputes). Code bodies work independently of market participants, they become a trusted critical friend and an advocate for the greater good of competition and consumers. Logically, there is no reason why this should change; however, whilst codes have been particularly adept at overseeing many forms of change (including incremental change), the proliferation of codes and what they deal with is in urgent need of reform. Not least because, they have on occasions already struggled to cope with some of the more significant strategic reforms required of them¹².

Setting better code governance boundaries by function, would allow for a better understanding where code governance functions might come together to facilitate that reform (see Fig.1 below). Functional definitions also help shape what a strategic code governance framework might look like. By focusing on functions and outcomes, separation along these boundary points avoids the inevitable governance decision making compromises that would otherwise arise, where divergent interests and priorities are at play e.g. networks versus retail.

We have separated out (for now at least) ‘Network Functions’ i.e. the major assets/ infrastructure elements (pipes and wires) from Smart (where Smart Metering is housed under the auspices of the Data Communications Company). Both form natural monopolies and operate under a price controlled licence regime. However, as consumers transition to prosumers, and the grid transitions to a smart grid, it could be that, in time, smart and networks merge into one discrete function.

Wholesale and Settlement functions help frame the significant commercial risks at play. In particular, it highlights the potential synergies and harmonisation opportunities that will emerge, especially as gas and electricity functions underpinning settlement policies and practices increasingly converge within a smart energy future.

¹¹ *Forbes*, 19th April 2016, *Why Smarter Homes Will Be A Million Times Better than ‘The Jetsons’*

<http://www.forbes.com/sites/deborahweinswig/2016/04/19/why-smarter-homes-will-be-a-million-times-better-than-the-jetsons/#5e324bcd41bb>

¹² *The CMA* (24 June 2016), *Energy Market Investigation*, section 318, P.74: identifies a combination of features of the wholesale and retail gas and electricity markets in Great Britain that are related to industry code governance and which give rise to an adverse effect on competition (AEC)



With respect to the Retail & Customer functions, this frames the touch point where consumers more often than not interact directly with service providers e.g. energy suppliers, such as in the case of customer switching and vulnerability requirements. This is perhaps where the organic growth of codes over the years has mostly proliferated, resulting in a disparate set of codes that should come together under one roof. A Retail Energy Code (REC) is therefore a good place to start, reducing governance costs and perhaps most importantly, presenting an opportunity to bring consistency, simplification, improved accessibility and coordination to this space.

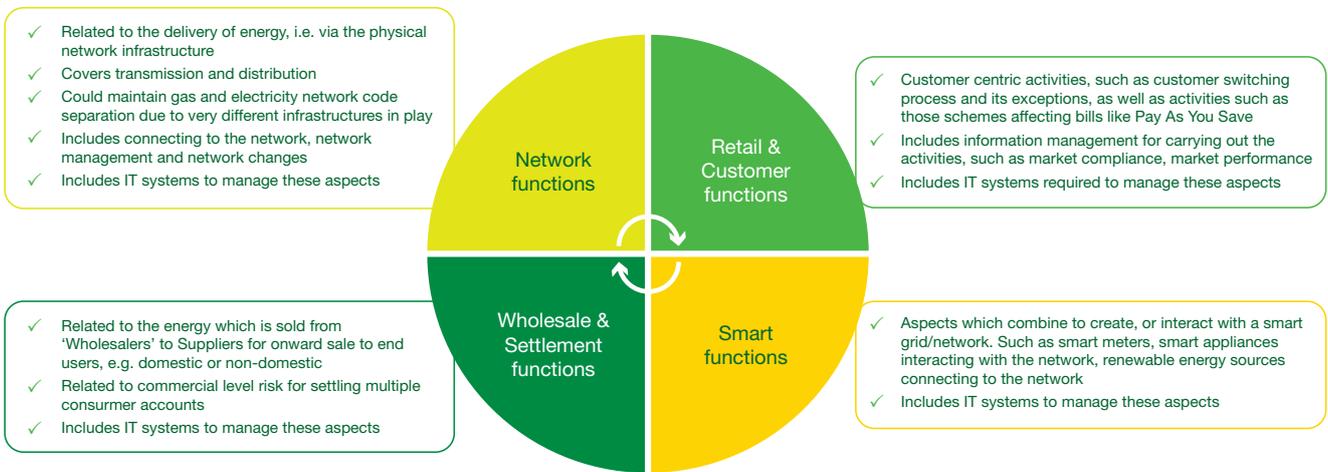


FIG.1: FUNCTIONAL BOUNDARIES



Framing the REC

Market participants do not yet have a holistic view across all codes, this is a weakness of the current code centric governance framework that exists today. This can lead to difficulties getting industry participant engagement, and problems for market participants targeting their limited resources.

A REC could, under a single code entity under one code manager, bring together the MRA, GDAA, SPAA and some parts of DCUSA, plus the retail elements still contained within other codes. It could also possibly include other non CACoP codes, such as the SMICoP¹³. The REC would house the functions that are pertinent to the interoperability, rights, duties, and obligations for those market actors, for example: change of supplier, retail market entry assurance, energy theft, objections, certain meter reading aspects, retail market reporting.

At this stage, we do not definitively set out the REC specification. We believe that this would be better served via an industry wide, cross code working group, to help define its target scope from which the specification can be built. This would take time to develop, and comes not without some effort to do so, especially given that the resources required are largely the same experts deployed elsewhere across other energy reform measures.

However, we would expect its development to embrace a Standard Code Model approach¹⁴. Consequently, it would not simply be a bolting together of all relevant codes (or sub elements of codes), rather it would be designed from the outset to be best of breed, and follow the five core principles:

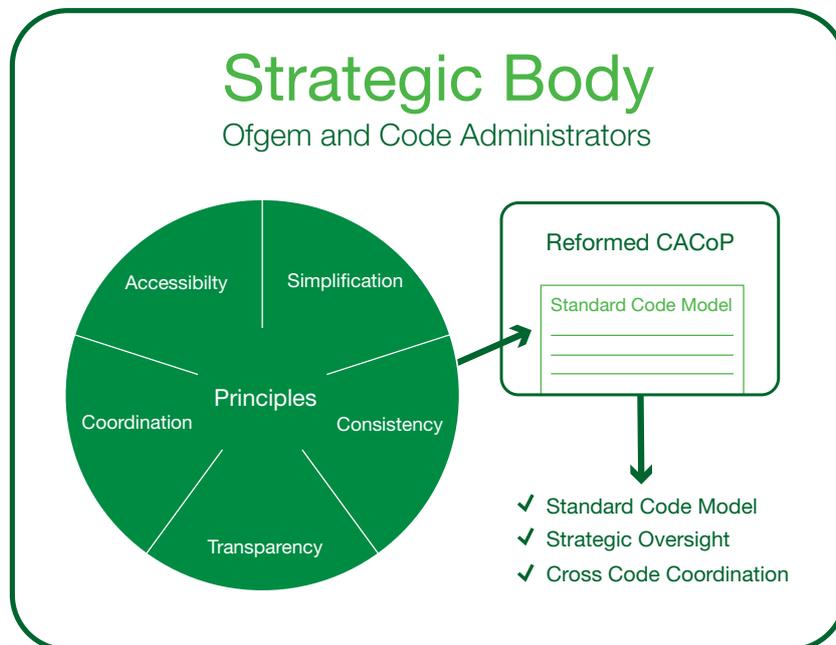


FIG. 2: THE STANDARD CODE MODEL

13. E-UK, <http://www.energy-uk.org.uk/policy/smart-meters/smart-metering-installation-code-of-practice.html>, accessed 3rd Jan 2017

14. Gemserv, 27 January 2016, *Transforming energy Code Governance Arrangements*, <http://www.gemserv.com/insights/thought-leadership-papers/transforming-code-governance-arrangements/>



How Would We Get There?

Any rewriting of the 'code governance landscape', should not introduce additional significant market risks at a time when the volume and complexity of change has already reached giddy heights. We have developed a proposed transition roadmap and timeline (see Fig.3), against which the following considerations are made:

KEY CONSIDERATIONS

- Future code changes need to be managed in a way that is consistent with the direction of travel for a strategic code governance framework, where boundaries can be set towards a code architecture model that is future proofed.
- Transition timing should cater for the significant energy reform agenda already underway, as well as taking due account of CMA remedy delivery.
- Ofgem's Faster and Reliable Switching Programme is already in progress, with a target of date of 2019 for full delivery. It will need a governance home until the REC is fully developed and in place. Preferably one that will make transition simpler, i.e. under an existing dual fuel code.
- Given the evolutionary nature of the new licensing regime for code managers and the proposed new Consultative Board¹⁵, it would be unwise to drive the REC ahead of a clearer understanding of what these look like and the obligations these entail.

WHERE TO START

A prerequisite is to ensure the way forward does not disrupt the delivery of the Faster and Reliable Switching Programme (by 2019). Developing a brand new code to house faster switching, in parallel with its delivery, could compromise go-live for 2019. We know from experience that developing a new code is not a simple or quick exercise - it takes time to get right.

Consequently, finding a governance home that is already dual-fuel conveys a distinct advantage in terms of future REC evolution, noting that market risks are best managed when:

- An existing code's governance and administration (funding, duly-elected governance, parties and Board) are deployed to facilitate a plan to move to a new 'shadow' code;
- Change is programme managed across relevant codes, via the use of tried and tested existing industry change management procedures;
- A transition plan/scheme is installed, to help manage the governance shift from its temporary host code, to the new target code;
- There are sunset clauses in the host code with specified run-down periods; and
- Enactment is facilitated in a managed fashion with proportionate parallel running or 'roll-back' facility to the host code(s), if the project slips or issues are encountered.

¹⁵ Ofgem, *Industry Code Governance, initial consultation on implementing the Competition and Markets Authority's recommendations (Jan 2017)*, p.32, https://www.ofgem.gov.uk/system/files/docs/2016/11/industry_code_governance_-_initial_consultation_on_implementing_the_competition_and_markets_authoritys_recommendations.pdf



We therefore believe that the faster and reliable switching rules/regulations and processes could be composed as a schedule to an existing dual-fuel code, such that it can be 'lifted and shifted' to a new REC. The legal work could be undertaken under the current Faster and Reliable Switching Programme terms of reference, incorporating sunset clauses to enable it to be transitioned. Critically, the legal work could be completed during 2018, noting that the faster switching governance regime must be in place in advance of the faster switching programme delivery. Importantly, it avoids the distraction of a REC consultation and implementation process at this critical juncture, i.e. it could involve a single exercise to secure both the REC and the licensee under a single code manager authority post-delivery of the faster switching reforms. Fig.3, sets out a proposed timeline.

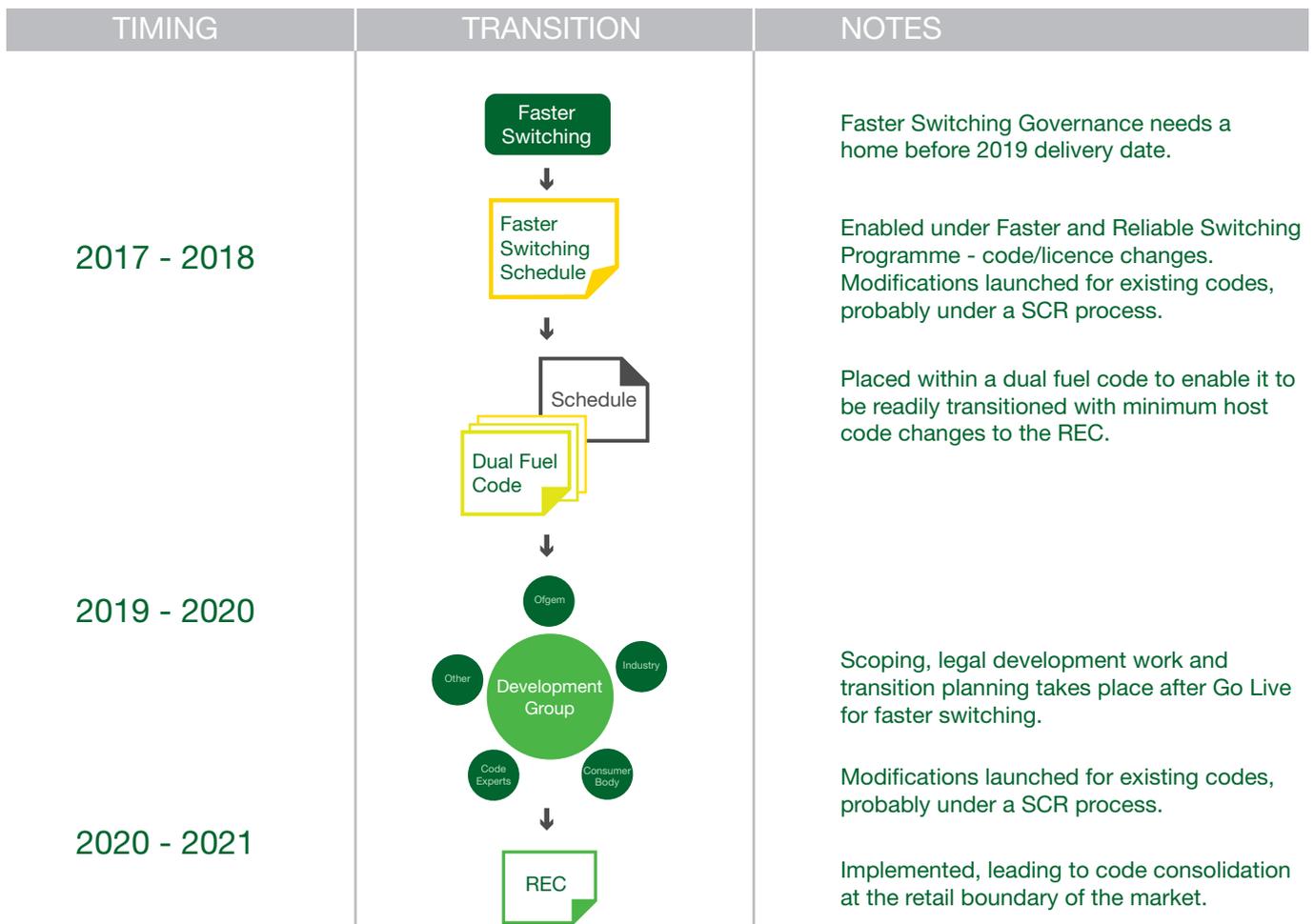


FIG.3 - REC TRANSITION



Next Steps

Many industry participants have responded to the CMA's energy market investigation with respect to code governance articulating the need for fewer codes. We believe this is driven ostensibly by the burden of participating across so many code governance panels and groups, as well as having to be party to such a varied range of codes, each with their own jargon, content, and processes.

Consequently, it would be wrong to drive governance for upcoming market reform measures, such as those anticipated under the Ofgem Faster and Reliable Switching Programme, without proper regard to a strategic approach to code governance. In practice, this requires adopting a sensible and pragmatic approach, one that works with the grain of market reform that is already well under way. It should be designed in a manner that can be 'lifted and shifted' to a future state governance framework, without risking the progress of upcoming market reforms. This means as a first step, utilising an existing dual-fuel code (e.g. SEC¹⁶).

In conclusion, taking all factors outlined in this paper into account, we believe the best approach would be to:

- a. House the faster switching governance within a schedule to an existing dual-fuel code during 2018, that can be readily lifted and shifted to the new future REC
- b. Develop the REC via a cross industry group, where all interested parties can come together including consumer advocates during 2018 to 2019, to give shape to the REC
- c. Devise and programme manage the REC through to go live, and then deliver the REC governance (potentially aligned with the birth of the new licence regime for code managers)

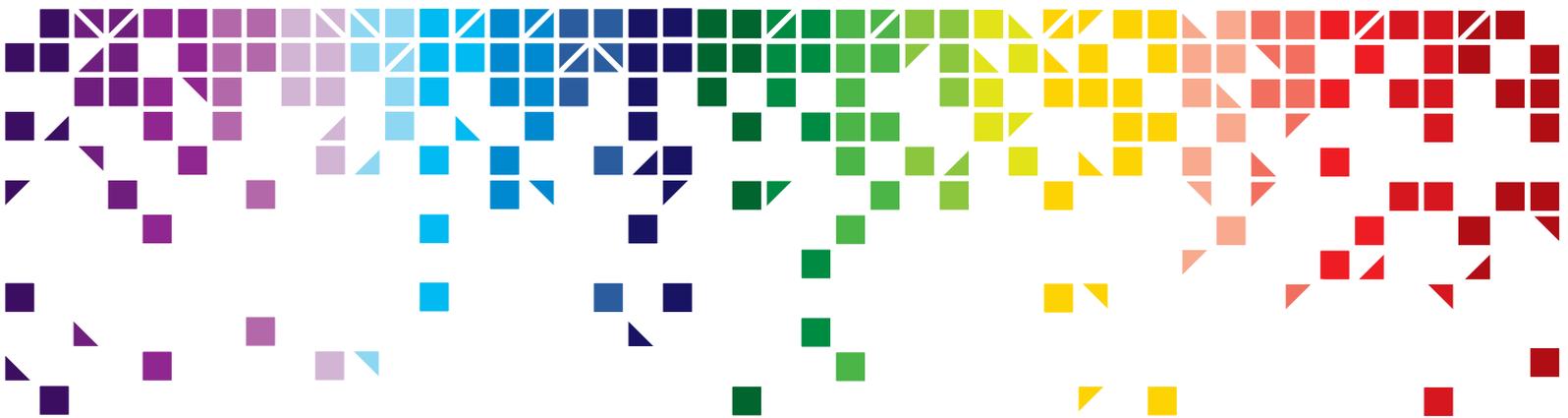
Energy markets are undergoing dramatic change, challenging preconceived ideas about the role and nature of consumers as we shift increasingly towards the age of the energy prosumer in a smart world. Energy markets are becoming ever more complex, but it does not necessarily follow that the manner in which market participants access and interact with industry codes cannot be simplified. We believe that an organic transition towards code consolidation is the right way to go.

We have suggested that our Standard Code Model¹⁷ could act to drive reform where it is needed most; embracing best practice, it will act as catalyst towards code consolidation, creating fewer codes with meaningful boundaries and accountabilities.

However, we should be cognisant of the significant reforms already underway. As a critical first step, we can recognise the need for a target code governance framework and work steadily towards that goal. This means housing faster switching governance within an existing dual fuel code in a manner that will enable it to easily transition to a future, best practice, consolidated Retail Energy Code.

16. Other candidate codes should not be ruled out (such as the MRA or SPAA), providing they are deemed to be dual-fuel at the time a decision is made.

17. Utility Week, Feb 2016, Energy code governance should build on what works.
<http://utilityweek.co.uk/news/energy-code-governance-should-build-on-what-works/1219542#.VyeIWfkr12y>



The solution and ideas represented in this thought leadership are those of Gemserv Ltd. They have been informed by the views and perspectives of those with whom we have engaged, including those that participated within Gemserv's Supplier Code Governance Forum.

To find out more about how we can help you, please contact Tony Thornton on:

T: +44 (0)20 7090 1014

E: tony.thornton@gemserv.com

W: www.gemserv.com

London Office:

8 Fenchurch Place

London

EC3M 4AJ

Company Reg. No: 4419878

