

# 293/18 – PANEL BRIEFING PAPER – BEIS/OFGEM CONSULTATION ON REFORMING THE ENERGY INDUSTRY CODES

**MEETING NAME** BSC Panel

**Date of meeting** 08 August 2019

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**Purpose of paper** For information

**Classification** Public

**Summary** The Panel is invited to note the summary of the proposals set out in the BEIS/Ofgem consultation document on reforming the energy industry codes, issued for consultation on 22 July, responses due 16 September.

## 1. Background

- 1.1 The Department for Business, Energy and Industrial Strategy (BEIS) and Ofgem published a consultation on reforming energy codes. As the Panel will be aware, we were anticipating an Energy White Paper; however, our intelligence tells us that the Government decided to approach the aspects of work that had been undertaken in relation to the White Paper by way of consultations. This is believed to be mainly because of the imminent appointment of the new Prime Minister, and the Government not wishing to tie the hands of future Ministers.
- 1.2 Therefore, the Energy Codes Review consultation is one of a set of documents that BEIS has published on future energy policy ranging from new arrangements to encourage nuclear power to plans for delivering carbon capture and storage.
- 1.3 The consultation explains that the codes have done 'a remarkable job' in setting industry rules. It also acknowledges the importance of industry expertise in creating 'a robust governing framework for the 2020s and beyond.' However, it recognised that the rules governing the energy system need to adapt much more rapidly to enable the transition to a more flexible energy system with net zero emissions.
- 1.4 The consultation goes into more detail of what Government and Ofgem are proposing in respect of reform to the Codes landscape, central to which would be one of the two models that Mary Starks presented at the BSC Annual meeting (see diagram below). The consultation is seeking views from stakeholders by 16 September, after which BEIS and Ofgem will update their proposals.
- 1.5 There are a number of elements where we believe we have managed to influence what is in the consultation, in particular around the scope of the review, which now covers not just code administrators (ourselves, ESO, Genserv, Electralink), but code management and the systems that underpin the codes. To that end, BEIS and Ofgem have confirmed that DCC, Xoserve and the Data Transfer Network (DTN) operated by Electralink are encompassed in the review. In addition, ensuring the code manager is properly resourced and empowered to raise and progress changes (something we advocated back in 2016 following the CMA review), is now proposed. Furthermore, the review outlines that BEIS and Ofgem are explicitly considering consolidation and simplification of the codes, as well as a more fundamental restructuring of the institutional framework (e.g. potentially consolidating code management).
- 1.6 On the consolidation and simplification point, the consultation document references the ELEXON Policy View document on our three code horizontal model and the presentation that we gave at the BEIS and Ofgem workshops in February 2019. Having spoken to BEIS and Ofgem we understand that the Cornwall Insight

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study, which we instructed, was too late to be included in the consultation document. We are, however, in the process of arranging meetings with BEIS and Ofgem to go through the detail of it.

- 1.7 Other elements from the CMA 2016 review, which we had understood had been abandoned, have disappointingly reappeared. For example, the concept of code managers being licensed and that code managers should be appointed by a tender, although the consultation admits the former was not previously supported by industry and the latter is referenced as a possibility rather than a principle.
- 1.8 One point that is clearly apparent is that BEIS and Ofgem see the need for a strategic authority (it appears in both models) and that Code Managers are either accountable to it (Model 1) or incorporated within it (Model 2). However, it will not be part of BEIS, although it could be *an option for Ofgem to be the strategic body in Model 1 (as well as the "economic regulator", by which it is referred to throughout the consultation)*. In addition, the document notes that if Ofgem were to take on more of a role in codes that it would require additional funding and expertise.

## 2. The Proposed Reforms

2.1 The consultation outlines that there are four areas where BEIS and Ofgem are seeking improvement:

- **Providing strategic direction** – proposing to create a new function/body that can take account of Government's vision for the energy system and translate it into a strategic direction for codes
  - This was a feature of the CMA findings, to create a strategic authority, but following several workshops in 2017 by Ofgem, it failed to progress, with Ofgem eventually citing competing priorities such as price cap. Back then the 'strategic direction' was accompanied by the need for 'cross code coordination'. If the issue is now solely strategic direction, a legitimate question is how extensive and how often is strategic direction required and is the proposal to create a new body a proportionate solution. Presumably, the strategic authority is accountable to government.
- **Empowered and accountable code management** – creating an empowered code manager function that has the right expertise, resources and powers to oversee the change process, monitor compliance with code obligations and decide on appropriate measures in the event of non-compliance
  - This is closer to the ELEXON model than other code manager models, and we have advocated this since 2016 albeit less vigorously than consolidation and simplification. A new development in this consultation is to make the code manager(s) accountable not to industry but to the strategic authority (which takes us back to the strategic authority point above).
- **Independent decision-making** – re-balancing decision-making away from industry control to arrangements that are agile and responsive to change and work in the interests of existing and future consumers
  - A manager with the power to raise change is one thing but we know that industry has always valued its ability to drive and influence the change process. Having said that, this concept has been heralded in the REC provisions and industry may focus on other topics.
- **Code simplification and consolidation** – improving accessibility and removing unnecessary content and ensuring that codes are adaptive to change
  - We note the ambition in this sub-heading isn't necessarily reflected in the wording of the description, but conversations with BEIS and Ofgem reveal an ambition to consolidate codes.

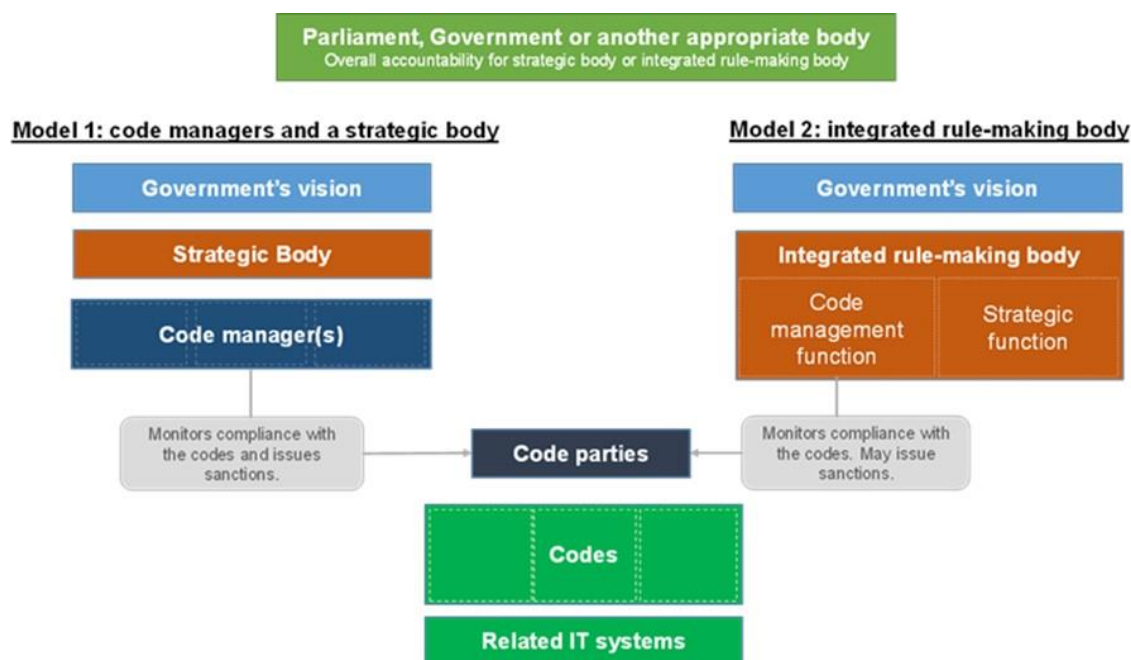
## 3. Providing Strategic Direction

- 3.1 As outlined by Mary Starks at the BSC Annual Meeting, BEIS and Ofgem are looking at two potential models to address the problem of fragmentation and a lack of co-ordination between the codes. These two models are:

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- **Model 1** – a code manager function and separate 'strategic body'; and
- **Model 2** – an 'Integrated Rules Making Body' (IRMB), which would be a combined code manager and strategic functions.



- 3.2 Under both models the Government would be responsible for articulating the vision and policy direction for the energy system, either through the Government's energy policy announcements and publications, or through a formal mechanism providing specific guidance. In either scenario there would be a requirement for the strategic body to take into account the Government's vision for the energy market and translate it into a strategic direction for the codes.
- 3.3 In Model 1 the strategic body would be a separate body from the code manager(s) function. For Model 2, the IRMB would include the strategic function and code manager function, with the model seen to allow for greater co-ordination between the two functions. Whether Model 1 (strategic body) or Model 2 (IRMB), each would be accountable either to Parliament, the Government or another appropriate body, such as Ofgem.
- 3.4 It is proposed that code managers would oversee the change process, potentially making decisions on some changes, consulting and working with industry on more material changes, and proposing solutions to the strategic body for approval. However, it is proposed that there is increased independence of decision-making and that the new bodies are incentivised to deliver in the interests of consumers. There appears to be a move away from considering industry's interests in all of the proposals put forward, although recognising that industry's participation is needed to assess and develop proposals.
- 3.5 It is highlighted that the "economic regulator" (i.e. Ofgem) would no longer have a role for proposing and approving modifications, or leading significant code change under either of the models.

#### 4. The Strategic Body

- 3.6 The consultation recognises that the strategic function will have to have credible incentives and powers to deliver strategic rule changes under either of the models, which are likely to go further than the Significant

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Code Review (SCR) powers currently held by Ofgem. In addition, the strategic body will have to be sufficiently resourced with appropriate skills and capabilities (e.g. complex programme delivery and energy sector-specific expertise).

- 3.7 BEIS and Ofgem have identified a number of options for where the strategic body could sit, these being:
- **Ofgem** – although the consultation highlights Ofgem would need to develop the necessary capabilities to perform the functions, in particular in relation to technical expertise, programme management and delivery capability. In particular, if Ofgem were to be the IRMB, under Model 2, it would also require Ofgem to have a more extensive role in detailed code development than it currently has. It is also noted that separate funding and governance would be required for Ofgem.
  - **Electricity System Operator** – however, it is recognised in the consultation that oversight of all codes would be a significant expansion of remit (e.g. retail, generation, distribution etc.) and would require a structural change to accommodate gas codes. It would also require a consideration of the separations put in place between National Grid (TO) and the ESO function. Furthermore, the consultation notes, “this new function would also need to be designed to mitigate potential conflicts of interest and would need a structure in place to ensure the correct accountability to consumers.” See also 4.4 below.
  - **A new independent body** – this is seen as challenging compared to other options that place the strategic function in an existing body, although it is noted that the reform package overall would simplify the institutional landscape, as BEIS and Ofgem are proposing a “smaller number of code managers would replace the current set of code administrators”.
- 3.8 The proposals envisage that industry, code managers and the strategic body would all have a role in delivering changes to the energy codes.

#### 4. The role of Code Manager(s)

- 4.1 The consultation outlines that BEIS and Ofgem believe that the introduction of a new code management function with greater responsibilities, powers and accountability would help facilitate change more effectively and that, despite putting in place the Code Administrators Code of Practice, the issues that the CMA identified still exist.
- 4.2 It is proposed that under either model, in model 1 under the Code Manager and in model 2 under the IRMB, there will be an explicit role in prioritising change and ensuring that change is focused on delivering the Government’s policy or vision for the energy system. The document does highlight that there are a number of options in terms of whether the industry will be allowed to raise and take decisions on modifications and suggests that there may be benefit in allowing the code manager function to delegate some decisions to industry, perhaps through a Panel. It should be noted that this is where the document talks of establishing an industry Panel. There is recognition that BEIS and Ofgem expect code parties to have the right of appeal to decisions made by the code management function.
- 4.3 There is consideration of the case for combining code and system management. In a consultation by Ofgem in 2016, Ofgem considered that the synergies between code management and system delivery were sufficiently strong that a single licence could cover the end-to-end delivery. The end-to-end model does seem to be the approach, which Ofgem is putting in place for the REC, but currently without the licence arrangements. It is, however, noted in the consultation that there was opposition to licencing and around the consistency of licencing relative to the current industry governance arrangements and disruption to existing organisations.
- 4.4 It is highlighted that while requiring existing licensees (we assume that they mean the ESO) to become the code manager function may expedite reforms, the initial preferred model for establishing the code manager function would be to tender for the role. However, further policy development is needed in this area and the document states that “if a bespoke body is not created” that BEIS and Ofgem would prefer to hold a

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competitive process. From this wording, it could be read that there is a presumption/stronger view in BEIS and Ofgem that a bespoke body is created, that there is no tendering and that model 2 would be adopted.

- 4.5 One criterion that BEIS and Ofgem are considering would require that no bidder has an affiliation with an existing party to the industry codes. It is noted that there is already a wide pool of code administrators who may be able to bid to become a code manager. However, BEIS and Ofgem remain open to how any reforms could be implemented, for example, including a transition phase.
- 4.6 Obviously, the proposal to have no affiliation with an existing party to the industry codes would be a concern to most of the existing code bodies, who are owned by industry parties. If this were replaced with the concept of “independent from” (i.e. not under the control), it would be acceptable to ELEXON.

#### 5. Code simplification and consolidation

- 5.1 It is stated that BEIS and Ofgem believe that fundamental reform of the arrangement of the code content is required to achieve their vision of delivering a framework of codes that is comprehensive, co-ordinated and agile and that this will address the current problems.
- 5.2 BEIS and Ofgem want to build on the positive developments of the REC and that these are taken forward as a part of the wider review. It is, however, recognised that aspects of the REC may need to be updated in light of the conclusions of this more fundamental review. It is also noted that it may be appropriate for the strategic body to lead this exercise rather than Government or “Ofgem as the regulator”, given the relative level of expertise required.

#### 6. Tackling non-compliance with Codes

- 6.1 There is a recognition that the future model needs to look at providing greater clarity to market participants on how performance is monitored against relevant code obligations. With the future arrangements moving away from an industry-led approach to instead being a function of the code manager. BEIS and Ofgem believe that having code development and monitoring in the same organisation may also bring benefits, as the body should be able to identify emerging issues and improvements in the framework. This sounds like the ELEXON model, but without an industry appointed/representative Performance Assurance Board.
- 6.2 It is noted that under both models, there would be an expectation of licensees being required by licence to comply with the relevant codes and, therefore, Ofgem would keep some role in relation to compliance.

#### 7. Next steps

- 7.1 The consultation is due for response by 16 September. A summary of comments will be published on the BEIS website. In the meantime BEIS and Ofgem will be continuing to work up proposals and expand their evidence base.
- 7.2 A further consultation will be issued later this year/early next year and depending on the outcome of the consultation it is expected that primary legislation will be laid at the earliest opportunity. In concluding, the document notes that code governance interacts with wider questions on system governance, including the split of responsibilities across Ofgem, the system operator and Government. Government are apparently currently “undertaking thinking in this area and intend to publish a position paper on system governance in 2020”.

#### 8. ELEXON’s initial thoughts and plans

- 8.1 We are considering the BEIS and Ofgem proposals in detail and also what further steps we might take following on from the Cornwall work. As mentioned earlier in the paper, we are organising meetings with Mary Starks and the Ofgem team and BEIS Codes Team to take them through the Cornwall study and discuss what else might be useful work to aid the review.

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- 8.2 It appears that while there are things that cause concern in the proposals, such as licensing, overall the proposals are positive when considered against ELEXON's objectives. The scope of the review now includes what we have been calling for: there is a proposal to reduce the number of Code Managers; there is an ambition to consolidate and simplify the codes; scope of the review now includes systems and service provision, not just administration; and code managers should be empowered and resourced.
- 8.3 In addition to the observations in paragraph 2.1 above, our initial internal thought is to prefer Model 2 since Model 1 creates yet another body. We would support the IRMB being either an enhanced existing body such as ourselves, or a bespoke body in which our resources and expertise feature in a future model, in line with our mission statement.

#### 9. Recommendation

- 9.1 We invite you to:
- a) **Note** the BEIS and Ofgem Code Review proposals
  - b) **Comment** and/or develop a response.

For more information, please contact:

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