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16 September 2019

Dear Sir/Madam,

**Northern Powergrid response to the joint Ofgem/BEIS July 2019 consultation on 'Reforming the Energy Industry Codes'**

Please find attached to this letter, Northern Powergrid's response to Ofgem's consultation on reforming the energy industry codes.

Our key points are summarised on the front page, and this should give you good sense for the content of our response. I would like to stress a few points:

Firstly, we welcome the review. Strategic direction of the industry codes is vital to support the significant change programme that is required to deliver a smart, flexible energy system. Overall, we consider there is opportunity to make changes to code governance that could ultimately improve benefits for customers by delivering quicker and more effective design and implementation of industry changes, but that might not be a 'one size fits all' solution.

Secondly we believe that initial focus should be on those codes that manage the commercial trading arrangements between parties and the industry systems that support those trading arrangements, rather than electricity network technical codes (i.e. the Grid Code and Distribution Code) where it is important to retain the close link between technical management and delivery.

Thirdly it is clear that the need for efficiency in making these changes is higher than ever with the draw on resources created by the start of negotiations the next price control arrangements, other Ofgem Significant Code Reviews and the potential impact of Brexit. All aspects of the review should be Ofgem led, to secure legitimacy of the outcomes. It is also important these choices are made openly and transparently and that the distributional implications are carefully considered before extra costs are imposed on particular groups of consumers, including those who have no control over the costs and especially those who are most vulnerable. There is a real risk that code reform could be gamed by rent-

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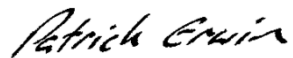
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seeking market participants at the expense of vulnerable customers, Ofgem and BEIS must guard against this.

Finally, we recognise that some of the proposals are likely to lead to increased cost - this is acceptable if the benefits exceed the costs, but we need to maintain a focus on efficiency - it is customers who will ultimately carry any increased cost burden in their bills. Hence, careful consideration needs to be given to the funding arrangements.

If have any question on our response we are more than happy to meet to discuss our views in more detail.

Yours sincerely,

A handwritten signature in black ink, reading "Patrick Erwin". The script is cursive and fluid, with the first letters of the first and last names being capitalized and prominent.

Patrick Erwin

Policy and Markets Director

## Consultation on Reforming Energy Industry Codes

### *Northern Powergrid's response*

#### Key Points

##### **We agree that changes to the energy industry codes are necessary and we:**

- Prefer Model 1 for the strategic body, as it provides a clearer distinction between the strategy and delivery roles.
- Are clear that Ofgem should be the strategic body and so do a complete job within the legislative remit provided by Government. Having a separate part of Ofgem as the strategic body with separate funding would be the second best option.
- Do not believe that the strategic body should sit outside of Ofgem as it would effectively give licensees two masters.
- Are clear that the Electricity System Operator (“ESO”) should not be the strategic body, given that it is already a licensee and market participant and, therefore, not independent. It also risks baking in a centralised approach rather than improving wider access.
- Consider that the overall system of code governance needs to police potential abuse by parties including risks of regulatory capture (i.e. the potential for parties to manipulate codes and use the change process to raise self-interest changes aimed at moving costs/risks to other parties).
- Would suggest that, as Ofgem is already the industry’s ‘chief policeman’, creation of another one must be avoided but the code manager(s) would add value as the ‘bobbies on the beat’.
- Stress the importance of maintaining the technical and commercial robustness of the code requirement to preserve the integrity of the electricity system.
- Highlight that as the electricity system becomes technically and commercially more complex there is a need for a robust set of rules so that each party understands and delivers on a set of unambiguous requirements. The technical codes need to be drafted as simply as possible with the content only as detailed and complicated as it needs to be.
- Believe that code changes that transfer costs between parties or assist “free riders” need to be prevented. Part of the role of the code manager(s) will need to be identifying these risks.
- Are happy for the code manager(s) to prioritise code changes via effective triage.
- Believe that the correct placement of the existing codes will be important, as issues could arise regarding which parties fund and control which codes.
- See opportunities for quick wins via code fragmentation and re-homing (e.g. moving electricity meter point governance to the Distribution Connection and Use of System agreement (DCUSA) as part of creating an electricity network code). Re-homing should be future-looking for the direction of travel of codes towards a smart flexible energy system.
- See benefits in having 4 codes: Wholesale; Retail; and separate Electricity and Gas Network codes.
- We would prefer having more than one code manager for the benefits of competition and benchmarking to drive best working practices.
- See challenges for Code Managers in securing specialist subject matter experts, including for the network codes given that much of the specialist industry expertise is within existing licensees.

## Responses to consultation questions

1. This is Northern Powergrid's response to the questions posed in the Ofgem/BEIS joint consultation on 'Reforming the Energy Industry Codes'

### Chapter 1: Background

***Question 1: Do you agree with our four desired outcomes for the code governance landscape by the mid-2020s? Yes/No/Don't know. Please explain***

***If you disagree, please explain what you consider the outcomes should be.***

2. Yes in generally but we have one additional observation. For network codes and other technical codes an additional desired outcome should be to have an arrangement of codes and code governance that are sufficiently robust so as to maintain the integrity and resilience of the energy supply system.
3. We see the logic of improving accessibility for an increasing number of parties, including the ease with which parties can identify the rules that apply to them (e.g. improving the portals into the codes and associated search tools).
4. We agree that the arrangements for changing the rules would benefit from being more agile, always provided that there is sufficient visibility, time and space for parties to engage with change proposals that may affect them and for the implications for GB more generally to be assessed.
5. We appreciate the need for the arrangements in the round to be more forward-looking in terms of the Government's ambition regarding the path to net-zero emissions and we see this as a core objective of the strategic body, with the focus of the code manager(s) being on developing and maintaining an agile change management process.

***Question 2: Do you agree with the problems we've identified (in chapter 1 – Background – and in later chapters), and that they present a persuasive case for reform of the current framework for energy codes? Yes/No/Don't know. Please explain.***

6. Yes, in part. The current codes are lengthy, contain many detailed rules to support a technically-founded industry and sit under different governing bodies, but we do not find them difficult to understand. We can understand why potential new industry participants might find it daunting and difficult to engage with the wide range of rules, especially if they lack previous energy industry experience. However, we should recognise that the code administrators already offer a high level of support to new parties in that respect. Some of the technical codes are necessarily complex as they deal with involved technical matters; a high degree of complexity is inevitable and it is likely that the level of detail required will increase as the nature of networks develop in the future.
7. There has been a drive towards industry self-governance over many years and there is merit in reviewing the outcomes to assess if any imbalances or unintended consequences have been created as a result.
8. We recognise the point regarding there being a single organisation under the existing framework that is responsible for looking at opportunities for consumers in the energy transition and how, with strategic direction, the codes could develop to facilitate those opportunities.

***Question 3: Do you have additional evidence on the performance of the current framework?***

9. For some change proposals, Ofgem has taken what appeared to be an overly long time to provide its decisions. However, this may be indicative of the high-level of industry change activity that has been taking place over the last few years, rather than a symptom of a problem with the codes themselves. This may reinforce the case for introducing a new appropriately resourced strategic body to oversee changes to the codes. There would be merit in considering the present range of governance arrangements so that their positive and negative attributes can be assessed; this would enable the best features of the present arrangements to be established and retained. Recent experience in the Grid Code has been that it can be difficult to find sufficient competent resources from across industry to progress change at a more acceptable rate.

***Question 4: Do you agree with our proposed scope of reform? Yes/No/Don't know. Please explain. If not, which additional codes or systems do you think should be included/excluded?***

10. Yes, in principle, but clarity on the approach to the technical/network codes is required. There may be merit in considering whether the GB Security and Quality of Supply Standards (SQSS) should be within the scope of the reform.

***Question 5: Are there any codes or systems that we should only apply a limited set of reforms to? Yes/No/Don't know. Please explain.***

11. Yes, potentially. Limited reforms may be appropriate for the electricity network codes. Significant work on these codes has been recently carried out by specialist subject matter experts to reflect the technical requirements of European Network Codes, including the Requirements for Generators, Demand Connection Codes and the Emergency and Restoration. Given the technical importance of these rules, including in relation to electricity system resilience, we suggest that serious consideration needs to be applied prior to proposing any reforms as it is ultimately the licensees (rather than a Code Manager) who would be held to account in the event of a major electricity supply incident.

## **Chapter 2: Vision and options**

***Question 6: Do you agree that the four areas for reform are required? Please provide reasons for your position and evidence where possible.***

12. Yes we agree with the proposed areas for reform, but would highlight necessary caution in any drive for simplification of technical rules that may create unintended consequences.

***Question 7: Do you agree with the two broad models outlined? Please provide reasons for your position and evidence where possible. – further detail can be found on each model in the chapters that follow.***

13. Yes, we understand both models. We have a strong preference for Model 1, as it provides greater clarity of roles and there is less scope for confusion over the boundaries of those roles.
14. Model 2 is far less preferable as it creates the risk of scope creep and unnecessary expansion of the Code Manager's activities through creating potential for it to have undue influence over the Strategic Body through having a relationship that is too closely connected.

***Question 8: Which model do you believe will best deliver on our desired outcomes? Please explain. NB: – further detail can be found on each model in the chapters that follow.***

15. We believe Model 1 will best deliver on the desired outcomes as it is much cleaner with clearly delineated roles and responsibilities. This will enable the strategic body and the code managers to each focus on adding value to their clearly defined functions in the new arrangements.

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**Question 9: Do you agree with the changes to the role of code signatories we are proposing?**

16. Yes, in principle.

**Chapter 3: Providing strategic direction**

**Question 10: Do you agree there is a missing strategic function for codes development in the energy sector and that introducing a strategic function with the responsibilities outlined in chapter 3 is the best way to address the lack of strategic direction? Yes/No/Don't know. Please explain.**

**Who is best placed to fulfil the strategic function and why?**

17. Yes, in part, but we think a function may be missing (i.e. to incorporate strategic direction with policy decisions and turn them, or incorporate them into, change programmes). Turning strategy and policy into clear deliverables requires a level of programme planning and management expertise which is fundamentally different from the skill sets required for policy development work and economic analysis.
18. Our preference is that Ofgem takes on the role of strategic body as part of its core activities by recruiting appropriate subject matter expertise and programme management expertise. Our second preference is to establish a strategic delivery function alongside Ofgem's more established functions, separately managed at Director level and reporting via the Ofgem Board to the Authority.
19. We see no benefits in placing this strategic function outside of Ofgem, as doing so could create the risk of unduly disconnecting policy development by Ofgem (e.g. via licencing and regulatory incentives), from policy implementation via the strategic Body. The strategic body needs to work in a synchronised way with the regulator and there is no better way to achieve than by having the strategic body within Ofgem's sphere of managerial control.

**Question 11: Do you agree with the objectives and responsibilities envisaged for the strategic function, and are there any additional objectives or responsibilities the strategic function should have?**

20. Yes, on the whole, but there may need to be an additional objective/role to ensure that changes being introduced are consistent with or coordinated with existing or planned legislative requirements and licence obligations (i.e. to address the risk of overlap or unintended consequences).

**Question 12: How may this new function potentially impact the roles and responsibilities of other parts of the framework? Do you foresee any unintended consequences?**

21. Yes, see our answer to question 11.

**Question 13: What are your views on how the strategic direction should be developed and implemented (including the option of establishing a strategy board to aid engagement)?**

22. We see logic in establishing a strategy board under Ofgem's remit, but not outside of it. A strategy board outside of Ofgem's remit could create conflict or confusion between the roles and responsibilities of BEIS, Ofgem and the strategy board.

**Question 14: Do you think that the scope of the strategic function should be limited to taking account of the Government's vision for the energy sector and translating it into a plan for the industry codes framework, or are there other areas it should address (for example, impact on vulnerable consumers)? Yes/No/Don't know. Please explain.**

23. We see merit in limiting the scope of the strategic function to translating Government's vision into a plan for industry codes (together with Ofgem's policies and potentially European Legislation). It is clearly very important that the impact of any aspects of plans (as driven by the Government's vision) that may affect vulnerable customers should be subject to appropriate consultation. The necessary requirements for such consultation could be included in its terms of reference of the Strategic Body if not included in its core scope. .

## **Chapter 4: Empowered and accountable code management and independent decision making**

***Question 15: Do you agree that in addition to the current responsibilities that code administrators have, that the code manager function should also have the following responsibilities?***

- a. Identifying, proposing and developing changes (analysis, legal drafting etc.), including understanding the impacts;*
- b. Making decisions on some changes, or making recommendations to the strategic body; and*
- c. Prioritising which changes are progressed.*

***Yes/No/Don't know. Please explain.***

24. Yes, in principle, but we would encourage caution around prioritising which changes are progressed in the context of change proposals raised by parties (e.g. to address perceived defects in existing arrangements) and more strategic change proposals to support policy direction or strategic vision. The topic of prioritising changes may always be a sensitive one with the risk of creating perceived winners and losers.

***Question 16: What is the best way to ensure coherent end-to-end changes to the codes and related systems? For example, is it through having end-to-end code and system managers?***

25. It is not entirely clear if this question relates to central industry systems or the systems deployed by individual parties to support industry arrangements. Small changes can be driven by code managers. However, changes implemented by parties against clear specifications and larger changes will need to be delivered via end to end programmes involving system managers.

***Question 17: Should the approach differ on a case-by case basis (i.e. depending on the code or system in question)? Yes/No/Don't know. Please explain.***

26. Yes, the approach should differ on a case-by case basis, including the nature of any system changes. End-to-end code and system managers would need to be involved in changes to core central systems, but more minor changes to systems owned by licensees may only necessitate the involvement of code managers.

***Question 18: Do you agree that the code manager function should be accountable to the strategic body and that this should be via a licence or contract? Yes/No/Don't know. Please explain.***

27. Yes, the code manager function should be accountable to the strategic body and this does not necessarily need to be via a licence. A fixed term contract per code manager should be sufficient (i.e. one that includes, among other things, performance measures and rights for early termination).

***Please note questions 19-26 only apply in respect of Model 1 (code managers and a strategic body).***

***Question 19: Are there more effective ways that the code manager function's accountability to the strategic body could be enshrined other than in a licence or contract? Please explain.***



28. No, we do not envisage any better ways to manage the necessary accountability.

***Question 20: Do you agree that we should not consider further a model whereby the code manager function is accountable to industry? Yes/No/Don't know. Please explain.***

29. No. Although we do not envisage a specific further model, we believe there should be routes into the new arrangements for industry parties to comment on budgets, expenditure plans and code work plans. This is because industry parties will be affected by the code manager's activities and its performance.

***Question 21: Do you have views on whether the code manager function should be appointed following a competitive tender process or other competition? Yes/No/Don't know. Please explain.***

30. Yes, in principle. We support competitive tendering for code management services as this should reveal the value being provided by different bidders. However, the procurement process needs to be sufficiently sophisticated to avoid an undue focus on lowest cost. In the arrangements proposed in the consultation, the code manager will need to recruit and retain skilled project managers and subject matter experts. Consequently, the procurement process also needs to reveal the bidder's approach to recruiting and managing such resources. Subsequent contracts or licences need to include consequences for failure to secure necessary specialist resources.

***Question 22: Do you think the code manager function should be established by the strategic body creating a body or bodies? Yes/No/Don't know. Please explain. If the code managers were established in this way, would we need to consider any alternative approaches to funding or accountability? Yes/No/Don't know. Please explain.***

31. Yes, we think the code manager function should be established by and be accountable to the strategic body. We are in favour of there being more than one code manager covering the three or four codes, as this should provide ongoing benefits of competition and benchmarking opportunities as well as driving best working practices. We see no reason why this should confuse parties and code access could still be via a single common portal for all codes.

Yes, we believe that alternative approaches to funding should be considered and we would appreciate further consultation on different funding options being carried out in due course.

***Question 23: In terms of establishing/choosing the code manager function, do you agree that we should not consider further:***

***a. requiring an existing licensee to become the code manager; and/or***

***b. requiring a licensee (or group of licensees) to create the code manager?***

***Yes/No/Don't know. Please explain.***

32. Q23a. Yes, **requiring an existing licensee to become the Code Manager** should not be considered further. We do not support the option of an existing industry licensee/trading party becoming the code manager, (e.g. the ESO), as we have significant concerns about the potential scope for conflicts of interest between an existing industry participant's commercial activities and the consultation's objective of creating an independent code manager. We would have no issues in principle with any of the existing independent code administrators (individually or collectively) or similar organisations competing for the code manager role(s), subject to the bidder's recognition that the role(s) will be different from some examples of existing code administration and include the addition of more specialist resources.



33. Q23b. Yes, **requiring a licensee (or a group of licensees) to create the code manager** should not be considered further. We have not identified any issues regarding the legacy arrangements of requiring a licensee (or group of licensees) to create codes and their supporting code administrators, as it is how the codes evolve that is more important. However, given the vision that Government and Ofgem have set out in the consultation, we can see why a different route to creating the code manager might be preferred. Managing perceptions and keeping parties on board will be important throughout the journey of code reform.

***Question 24: What would be the most effective way to ensure the code manager function offers value for money (for example, through price controls or budget scrutiny)? More broadly, what is the right incentive framework to place on the code manager function? Please explain.***

34. Employing the code manager via an appropriate contract should be a sufficiently effective way to ensure the code manager function offers value for money. We think it would be worth carrying out a lessons learned exercise to look at the pros, cons, delivery costs and features in existing code administrator contracts. For example, some codes consult on budgets and some do not.
35. Worthy of specific consideration, as an example, is lessons from recent changes to the governance of the Grid Code and whether the changes that were intended to deliver more openness, transparency and speed have actually delivered.
36. Cost benefit analysis should be undertaken to assess the operating costs and value delivered by existing code administrators. The different code administrators were established to serve particular purposes under each code, for example with different levels of centralised change development or de-centralised change development by change proposers and code parties.
37. When the Government and Ofgem have narrowed down their preference for a governance structure it will be easier to envisage the required features for contract or licences (which may include requirements to set high level and project specific plans (with any budgets), to consult on those plans and to report against them) and we would appreciate further consultation on this aspect in due course.

***Question 25: Are there any factors that:***

***a. would stop parties (including code administrators) from becoming a code manager?***

***b. should prevent parties from becoming a code manager (e.g. do you agree that licensees should not be able to exercise control of the code managers)?***

38. Q25a. No, in principle, we do not see any significant factors that would stop existing code administrators evolving into the code manager(s) role. We are confident the existing code administrators would recognise that the envisaged role is different to more traditional code administration in a number of ways and requires the addition of more specialist resource.
39. Q25b. The risk of conflicts of interest should prevent licenced parties from becoming code manager(s). We do not support any option of an existing industry licensee/trading party becoming a code manager (e.g. the ESO). We have significant concerns about the potential scope for conflicts of interest between an existing industry participant's business goals and the consultation's objective of creating an independent code manager.

***Question 26: How should the code manager function be funded (for example through licence fees or by parties to the code(s))?***

40. The code manager(s) should be funded by the strategic body. Our strong preference is for Ofgem itself to be the strategic body, which in turn points to funding via Government or licence fees. However, such funding arrangements need to be appropriately managed and avoid the risk of creating industry ‘free-riders’.

## Chapter 5: Code simplification and consolidation

### **Question 27: Are there any quick wins that could be realised in terms of code consolidation and simplification?**

41. As the electricity system becomes technically and commercially more complex there is a need for a robust set of rules so that each party understands and delivers on a set of unambiguous requirements. We agree that code simplification is an important goal and that a more generalised approach may not be appropriate for all elements of the codes due to the risk of unintended consequences.
42. We recognise the potential opportunities and benefits from simplification of code access via digitalisation in order to help parties identify the code obligations that apply to them. We are unsure if this can be classed as a quick win but it may be achieved more quickly than code simplification and the substantial task that will be rationalisation of all the legal drafting.
43. There may be a quick win from fragmenting existing code topics to assess opportunities for early re-homing. For example, moving electricity meter point administration service (MPAS) governance to the Distribution Connection and Use of System agreement could be a useful early step to creating an electricity network code. Re-homing should be future-looking for code direction of travel for smart/flexibility.
44. We have identified a number of potential quick wins that are not necessarily part of code simplification and consolidation, including:
- a. Providing additional documented guidance look-up facilities on which parts of codes are applicable to particular parties.
  - b. Requirements on all code administrators to have workshops or surgeries specifically aimed at new entrants.
  - c. Codes establishing funding for new entrants / smaller parties to become proactively engaged with industry change processes. We note the positive move for the Retail Energy Code change arrangements to utilize webex facilities where possible rather than face-to-face meetings.
  - d. Require code administrators to identify sections of codes that are redundant and could be deleted with no impact

### **Question 28: How many codes would best deliver on the outcomes we are seeking under these reforms?**

45. We see merits in the approach under Option B on page 40 of the consultation giving potentially four codes (i.e. retail, wholesale, electricity networks and gas networks). We see benefits in separating the Electricity and Gas Network codes and the Electricity Network Code will need to be managed by a technically qualified Code Manager. We would like to see further information regarding any envisaged merits of combining the electricity and gas network codes before we comment further. We see consolidation by industry activity type as having merits that will potentially be particularly appropriate for the dual fuel retail codes.

**Question 29: Which option (one code manager versus multiple) would best deliver on the outcomes we are seeking under these reforms?**

46. We would prefer at least two code managers to maintain the benefits of comparison, benchmarking and to drive best working practices. Please also see our answer to question 22.

**Question 30: Which of our consolidation options would best deliver the outcomes we are seeking to achieve? Please provide evidence for your examples.**

47. A variation on Option B on page 40 of the consultation is, in our view, the most appropriate consolidation options. Our evidence is based on our experience that code parties tend only to engage with code change processes on topics that affect them directly, for example a new entrant supplier with a focus on gaining domestic market share would focus on those aspects of specific codes that are relevant to its business model. Based on our experience the consolidation of codes by activity type (e.g. dual fuel for retail and wholesale) under Option B should support parties and new entrant access more effectively than Options A and C. Please also see our answer to question 28.

**Question 31: Do you agree that the codes should be digitalised? Yes/No/Don't know. Please explain.**

48. Yes, we see merits in digitalisation, especially for searching and look-up facilities, including improving access to detailed code obligations captured in sectionalised documents. Please see our answer to question 27. However, we have not encountered any problems with accessing the full pdf versions of the relevant codes and they remain very useful in setting out our obligations alongside the obligations of others on the same and related topics. The full code versions are also useful for assessing legal drafting in change proposals in the context of the relevant code section. Any move to digitalisation should also include the retention of the full pdf versions to give parties options on how they wish to access codes.

## **Chapter 6: Monitoring and compliance**

**Question 32: What role should industry have in monitoring code compliance or making decisions on measures needed to address any identified non-compliance?**

49. Industry parties should, in the first instance ensure their own compliance with codes in support of their related licence obligations. We are comfortable that monitoring compliance and addressing non-compliance should sit with the code managers and ultimately Ofgem. An example of monitoring under current arrangements is the auditing carried out by Elexon to support the accuracy of settlements under the Balancing and Settlements Code.

**Question 33: Which of the two models we propose would better facilitate effective monitoring and compliance arrangements? Please explain.**

50. We support Model 1 in providing the best structure for clarity of roles and avoiding blurred edges between the strategic body and the code manager. In that context, we understand the logic of the proposal that, under Model 1, the code manager would be responsible for identifying any action needed to address any events of non-compliance. However, we see merits in retaining efficient routes for any appeals, including for example appeals to the strategic body under Model 1.

**Question 34: With Model 2 - integrated rule-making body - should the IRMB have responsibility for imposing measures (where a party is non-compliant with the code) or should this be for another organisation? Please explain. Please note this question only applies in respect of Model 2 (integrated rule-making body).**

51. We are not in favour of Model 2 and this question points to a potential conflict in role for the integrated rule-making body in that it could end up having responsibility for compliance monitoring, imposing

measures and, potentially, receiving appeals against those measures. Under Model 2 logic, fairness and transparency would set the need for Ofgem to deal with appeals whereas, under Model, 1 the strategic body could hear appeals against measures imposed by the code manager.