



ADE Response - Consultation on Reforming the Energy Industry Codes | 16 September 2019

Context

The ADE welcomes the opportunity to respond to BEIS and Ofgem's consultation on **Reforming the Energy Industry Codes**. The ADE is the UK's leading decentralised energy advocate, focused on creating a more cost effective, low-carbon and user-led energy system. The ADE has more than 150 members active across a range of technologies, including both the providers and the users of energy equipment and services. Our members have particular expertise in demand side energy services including demand response and storage, combined heat and power, heat networks and energy efficiency.

ADE Draft Response

1. Do you agree with our four desired outcomes for the code governance landscape by the mid-2020s?

The ADE agrees with the four desired outcomes. While they are all high level, they provide a useful guide to what a future code governance landscape should look like.

2. Do you agree with the problems we have 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?

The ADE agrees with the problems identified to a large extent. While some energy codes are less susceptible to these problems on an individual level than others, none is free of them. It is also clear that the overall system of energy code governance faces the problems identified.

In particular, the current code governance process is extremely resource-intensive to engage in, with an average of sixteen full day workshops for each modification. This represents a significant barrier to participation by smaller players, many of whom are driving innovation and the energy transition, due to lack of resources and spare capacity. This results in a code governance process where the views of smaller players are underrepresented, and large incumbent players' views often dominate.

3. Do you have additional evidence on the performance of the current framework?

The ADE does not have any additional evidence.

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

Yes.

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.

No.

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

The ADE supports the four areas of reform required to varying extents:

Providing strategic direction

The ADE strongly agrees that reform in this area is required; changes are currently too fragmented and often lack strategic direction. It is essential that the body tasked with providing strategic direction be independent of industry considerations. The strategic body should be placed on a statutory footing, in a manner similar to the Committee on Climate Change.

Empowered code management

The ADE supports the principle of empowered code management, but this area of reform is heavily dependent on the identity of the code manager. While some code administrators are likely to be effective code managers, balancing the requirement to drive strategic change with the need to listen to industry views, others are not. The ADE's support for this area of reform therefore depends on the identity of the code manager chosen.

In principle, however, this area of reform would be extremely welcome. ADE members have emphasised the value of an engaged code administrator like Elexon, acting as a critical friend and aiding the drafting and development of modifications. An empowered code manager could play a valuable role in aiding smaller market participants to drive the changes necessary to promote innovative new business models.

Moving decision-making away from industry

The ADE supports the motivation behind this area for reform – driving agile and responsive change – and supports a greater proportion of modifications being raised by an empowered code manager than by industry.

Moving decision-making away from industry entirely, however, may create unintended consequences. Such an approach has the potential to disconnect decision-making from industry insight and expertise. A model where industry no longer had the formal power to raise modifications or take decisions on whether to change a code, as discussed on p.31 of the consultation, could be damaging to new market entrants and innovative business models, rendering regulation unresponsive or poorly thought out.

Maintaining some role for industry to propose and develop code modifications provides important checks and balances. This important safeguard allows smaller market participants who lack the money or profile to engage directly with the strategic body to still advance beneficial and innovative policy change.

The optimal approach may be to pursue several of the other reforms outlined – establishing a body to provide strategic direction, increasing the power of code managers, and simplifying and consolidating codes – while seeking innovative ways to engage smaller market participants in the process. A greater proportion of modifications should be driven by the strategic body and code manager functions, but industry should retain some ability to propose, progress and implement code changes.

Simplifying and consolidating codes

The ADE strongly supports this reform, provided that it is possible to implement in a manner that reduces the burden on market participants, rather than increasing it. Consolidation of the

wholesale, balancing and network codes across electricity and gas, for example, could risk increasing complexity and burden. Reforms will have to be carefully designed in order to avoid this risk.

7. Do you agree with the two broad models outlined? Please provide reasons for your position and evidence where possible.

In principle, the ADE supports the models outlined. As above, however, the extent to which the ADE agrees in practice will be determined by the identity and remit of the strategic body and code manager functions.

8. Which model do you believe will best deliver on our desired outcomes? Please explain.

Model 1 has a number of advantages, particularly in that it provides a stronger means of appeal if an industry party feels that their modification or interests have not been fairly treated by the Code Manager. It should also allow the strategic body to focus on its role in coordinating and setting direction, while delegating the detailed process of implementing code changes.

The IRMB suggested in Model 2 risks becoming unwieldy due to the volume of its duties, limiting the number of areas of strategic change that can be pursued at any one time.

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

The ADE agrees with the changes to the role of code signatories proposed in Table 4, subject to the identity of the Code Manager and Strategic Body.

10. Do you agree there is a missing strategic function for codes development in the energy sector and 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.

Yes.

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

The ADE believes that the strategic function would be best fulfilled by a new, independent body. This would help avoid the risk of competing priorities and increased complexity that could be created if an existing body were to fulfil the function. It is essential that governance and funding arrangements be established that enable any new body to acquire the appropriate skills and capabilities for its role, which would be different to the skills and capabilities provided by any of the existing bodies mentioned, such as Ofgem and the ESO.

An initial proposal would be for the strategic body to be established on a statutory basis, in a similar way to the Committee on Climate Change. The body would have statutory duties around carbon emissions, linked to the CCC's carbon budgets, fuel poverty and energy security. The body would set the overall strategy for driving changes to the codes, with an empowered code manager implementing the detailed changes. The strategic body could also help coordinate the government, Ofgem and the CCC to oversee implementation of the regulatory changes necessary to promote a low-carbon, flexible system that is compatible with the UK's climate targets.

While the ADE believes that the establishment of new strategic body would be the best option, we recognise that Ofgem already has some of the relevant powers, duties and accountabilities. If Ofgem were able to present a convincing plan for development of the additional functionalities needed, such as technical expertise, programme management and delivery capability, as well as separate governance and funding arrangements, it could be a viable candidate for the role. There is a significant risk, however, that this would be complex to achieve and result in an unwieldy organisation, given the necessity to acquire significant new expertise and capability. Ofgem taking

over the role would also necessitate a significant expansion of their duties, particularly in the area of carbon reduction.

The ADE does not believe that National Grid ESO would be suitable to perform this strategic function. There is due to both the risk of conflicts of interest and to low levels of stakeholder satisfaction with the ESO's current code administration function.

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?

The ADE agrees with the objectives and responsibilities set out in the consultation.

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

The ADE does not have a view on this 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)?

The ADE supports the idea of establishing a strategy board to help steer the process. It is essential that this board contains sufficient representation of smaller, innovative market participants.

The strategic direction should be communicated on an annual basis, with opportunity for industry to comment on at least one draft before the final contents of the strategic direction for the year are decided. It should contain detail of the work programme intended to be undertaken and should explicitly respond to any industry feedback.

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.

The strategic function should take the recommendations of other actors into account, such as the Committee on Climate Change, particularly with regard to achieving the net zero target.

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.**

Yes.

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?

Yes, if the end-to-end code and system manager is well-resourced and possesses the requisite capabilities. Such an approach has generally proven effective under the BSC.

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.

No. The end-to-end code and system manager approach should be applied to all codes.

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.

Yes.

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

The ADE does not have a view on this question.

20. Do you agree that we should not consider further a model whereby code managers are accountable to industry? Yes/No/Don't know. Please explain.

No. The ADE believes that code managers should be accountable to a number of parties, including industry. While we note Ofgem's expectation that the views of industry stakeholders would be reflected when holding the code manager to account, we believe it is important that this is undertaken via a formal process, with clear accountability to industry. Nevertheless, the ADE understands Ofgem's view that complete accountability to industry is likely to prevent increasing independence of decision-making. We therefore believe that the code manager should be accountable to both the strategic body and to industry.

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.

Yes – the code manager function should be appointed following a competitive tender process. It is important that, where existing licensees are bidding into the tender, the process takes past performance and industry satisfaction into account.

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.

The ADE does not have a view on this 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.

Yes. The code manager function should be put out to competitive tender. The ADE also agrees with Ofgem's view that there are not clear benefits to requiring a licensee to create the code manager – a range of code administrators exist who can bid to become code managers and it is unclear whether there would be value in creating a new code manager.

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.

The ADE does not have a view on this 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)?

The ADE believes that licensees should not be able to exercise control of code managers. This means bidders with an affiliation with an existing party to the industry codes should not be able to become code managers.

Stakeholder satisfaction with current code administrators should also be taken into account. Some code administrators are far more effective in facilitating innovative change than others, particularly through their implementation of the 'critical friend' role.

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

Ofgem should consider whether funding by parties to the code could threaten the independence of decision-making that they are seeking to achieve. Funding via a license fee may be most appropriate, but Ofgem should conduct detailed analysis of the likely consequences of different funding models.

27. Are there any quick wins that could be realised in terms of code consolidation and simplification?

The ADE does not have a view on this question.

28. How many codes would best deliver on the outcomes we are seeking under these reforms?

The ADE believes that Option C is likely to lead to the best outcomes, with a dual fuel code for all retail elements and separate gas and electricity codes for wholesale and balancing and for networks. This would result in five codes in total. While it is important to consolidate the codes as far as possible, merging gas and electricity codes for wholesale and networks is likely to significantly increase the requisite expertise at both the code management and industry engagement level. This risks making the code governance framework harder to engage with for new market entrants.

The ADE recommends that Ofgem conduct and publish a detailed analysis of each option for the number of codes, then seek industry feedback on this analysis.

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

The ADE believes that, ideally, one code manager would drive the changes that these reforms are seeking to achieve. If, however, no single code manager has the expertise to oversee the five codes mentioned above, there could be scope for multiple code managers. If this were the case, it would be essential that the strategic body play an active role in coordinating the code managers.

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

As indicated in the consultation, the options are not mutually exclusive. Given the length and complexity of the codes, it is essential that rationalisation, simplification and digitalisation are pursued simultaneously.

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

Yes.

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

The ADE does not have a view on this question.

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

The ADE does not have a view on this 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 rulemaking body)

The ADE does not have a view on this question.

For further information please contact:

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