

Industry Code Governance: Initial consultation on implementing the CMA's recommendations

Response on behalf of the Solar Trade Association

About us

Since 1978, the Solar Trade Association (STA) has worked to promote the benefits of solar energy and to make its adoption easy and profitable for domestic and commercial users. A not-for-profit association, we are funded entirely by our membership, which includes installers, manufacturers, distributors, large scale developers, investors and law firms. Our mission is to empower the UK solar transformation. We are paving the way for solar to deliver the maximum possible share of UK energy by 2030 by enabling a bigger and better solar industry. We represent both solar heat and power, and have a proven track record of winning breakthroughs for solar PV and solar thermal.

Respondent details

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| Respondent Name: | Nick Wood (Policy Analyst) |
| Email Address: | consultations@solar-trade.org.uk |
| Contact Address: | 53 Chandos Place, London WC2N 4HS |
| Contact Telephone: | 0203 637 2945 |
| Organisation Name: | Solar Trade Association |
| Would you like this response to remain confidential? | No |

Introduction and background

The energy system is going through a period of welcome and necessary change. We need to decarbonise as quickly as possible while keeping bills low for industry and for consumers. There is now little trade-off between these goals given the dramatic cost reduction seen in wind and solar in particular, and the huge potential savings that a smarter systems can deliver. Following the introduction of capacity market payments and competition from zero marginal cost renewables, wholesale prices have been deflated and are no longer driving investment; new structures are needed to ensure sufficient generation capacity. Technological advancement is disrupting old business models and unlocking innovation, but too often this innovation is constrained by a regulatory framework that has failed to keep pace.

Realising the benefits of the energy transition requires clear policy direction and careful coordination. We need to ensure we meet our policy objectives as swiftly and smoothly as possible whilst also instilling investor confidence, as this will enable the market to deliver maximum benefits for consumers. However, industry code governance is also a highly technical area with complex webs of interrelationships, so there is a high risk of unintended consequences when any changes are introduced.

The current system of self-governance of the codes was perceived to be a relatively effective mechanism for delivering this. On the positive side, it enables change designed by experts 'in-the-know,' with an iterative process for arriving at common-ground solutions. However, there are major shortcomings such as; a lack of coherence between codes; conflicts of interest/self-interest of industry incumbents; and underrepresentation of smaller parties. As such, the structure of self-governance tends towards resistance to change, inertia in delivering new policy objectives and maintaining a status quo that is misaligned with our future needs. We welcome Ofgem's intention to address this, but have some reservations about the proposals set out. We outline these below.

Following meetings with Ofgem staff and having collected views from our members, we are responding to Ofgem's proposals at a high level. As such we are not responding to individual consultation questions. We understand Ofgem strongly intends to implement the processes as outlined in the consultation, and offer the following feedback to guide for that process. We look forward to working with Ofgem throughout this ongoing review.

Response to the consultation

We welcome Ofgem's intention to achieve greater coordination across the codes for identifying and delivering strategic change that benefits consumers and competition. Traditionally solar has been "on the fringes" of code governance, as our members don't have the resources of the incumbents to support representatives on the panels. Participating in the current modification process is highly time-consuming, requires a high level of technical and in some cases legal expertise, and is difficult to engage with unless you are a signatory to the code - even where decisions being made impact your own commercial interests. As such, renewable and smart technologies are increasingly being frustrated by code modifications raised and implemented by panels in which they are disenfranchised.

Clear examples are the delay in implementing half-hourly settlement, which is needed to unlock a smart, local energy system, for which solar PV will form the bedrock. Another example is the removal of embedded benefits that Ofgem is minded to support (see Box 1), directly contradictory to the chapter on price signals in the call for evidence on a smart, flexible energy system. As a result there is slow progress opening up markets even where industry is ready to provide solutions, and more generally an inability to implement strategic change that would be of significant benefit to consumers.

However, while we agree with Ofgem's intent, we are not persuaded that the solutions outlined will sufficiently resolve the issues outlined. Our recommendations and key observations are summarised below and enlarged upon thereafter:

- **We strongly welcome the injection of strategic direction into the Code processes.** This is essential. Strategic direction should be principles-based rather than prescriptive, and should be coordinated with (and perhaps set by) BEIS.
- **More detail is needed on the governance and structure of the proposed consultative board** before we can comment on its efficacy.
- **Licensing code managers does not solve the problems the review aims to resolve**, such as conflicts of interest among code parties frustrating strategic change, and **by further concentrating influence into incumbents this proposal may in fact exacerbate the problem.**
- **Ofgem should consult on merging the codes.** This seems a workable solution to many of the problems identified and we are unclear why it is outside the scope of this consultation.

- **Ofgem should explore giving the right to raise and edit modifications to other parties**, such as distributed generation and other market entrants with commercial interest at stake.
- Problems relating to **fair representation and resourcing of representation** on the code panels and the consultative board, particularly from new entrant technologies/business models, are not addressed in the consultation, despite being essential to securing better outcomes.

Setting the strategic direction for codes

Proposals to inform strategic direction are overdue and welcome. Management of the codes must allow for forward-thinking in a way which has been frustrated so far. For example, how to adapt to the need for more renewable energy, technological developments in storage and demand-side response, network upgrade deferral, out-competition of old business models by non-traditional business models and future marketplace re-design. We fully agree that code modifications must be answerable to the strategic direction in some form or other, and there must be a workable mechanism for this feeding into the codes. One consideration is that Ofgem's remit is the protection of current and *future* customers. This could be applied to the strategic direction.

However, this must be balanced with the reality that the knowledge and intellectual capacity of industry is essential to ensure ongoing good governance of the codes. By nature, companies have a greater understanding of the impact of code modifications on their business and on the market as a whole. Indeed, while conflicts of interest/self-interest of code parties is a cause for concern, the system of self-governance works (to some extent) precisely because of the commercial interests at stake (i.e. all parties working together to find common ground). Ofgem may not be the best-placed party in leading the call for modifications that serve a commercial purpose.

Furthermore, the regulator will have a particular view of the strategic direction, which code parties may or may not agree with, depending on their position in the market; there will be winners and losers. Of course the industry is not homogenous, and indeed that Ofgem is not homogenous, with different departments supporting different viewpoints.

Finally, depending on the strategic direction identified, it may not be fully aligned to Ofgem's remit or its existing powers to implement.

On that basis, we believe **the strategic direction should be principles-based**, rather than prescriptive: i.e. low cost for consumers, low carbon, security of supply, fair competition.

We also believe **the strategic direction should be directed by BEIS** (or at least BEIS in partnership with Ofgem).

The consultative board

In principle we can see the merits of the consultative board, but in practice further questions arise. As Ofgem has noted, this consultation addresses only the role of the consultative board, but not its governance or structure, yet the latter are key.

The coordination role is very welcome, and the board would enable better 'project management' of code modifications where several are necessary across multiple codes for implementing policies in line with the strategic direction. Currently the approach is siloed, with little explicit consideration in code

February 2017

governance of how modifications will impact other industry segments (for example, the unintended consequences pertaining from the embedded benefits review).

However, without information on who will populate the board, how it will run, and who resources it, it isn't possible to determine the efficacy of this proposal. Ofgem is clear that it isn't their function to deliver the project management of code modifications, and they want to step back from having to enact significant code reviews. However, adding another decision-making layer does not achieve the goals of the strategic direction per se.

There is also no clear intention to resource a consultative board, which may need frequent meetings, a secretariat, a joint-industry plan/work plan, etc. It is unclear how this will be resourced, and how it will be ensured that it is run objectively if it is left to industry. If it is not left to industry, and partly under the aegis Ofgem, it is unclear what the purpose is. This proposal needs to be more clearly set out in the consultation process later in the year.

Licensing and competition

We are concerned by the proposal to license code administrators.

We accept the view that there should be a means for prioritising between modifications, and with code managers in place this would be possible. We also welcome the proposal that code panels and modification procedures should be aligned to the strategic direction and accountable for this.

However, we see a substantial risk of exacerbating conflicts of interest and problems arising from the self-interest of individual companies where more influence is concentrated in one industry party. We believe there is a good case for taking the administrator role away from individual signatories to the code, as they can frustrate change in line with their specific commercial interest (for example DNOs (who own electricalink) on the DCUSA and National Grid on the CUSC). It is not inconceivable that companies could abuse positions of influence and prioritise modifications that are in line with their own commercial interests over broader public interest.

In addition, these are positions that will favour incumbents due to considerable asymmetries in resources, expertise and knowledge. Incumbents will naturally have a better chance of securing tenders for code manager positions over new entrants, and the result will likely be even more tilted in favour of the status quo rather than representation of the needs of smaller parties or the strategic change. Competition does not always provide the optimal or indeed most efficient solution, and in cases such as this we perceive instead comes with significant risks.

It is essential in our view that this asymmetry of resourcing and expertise is proactively corrected. How to achieve this requires further thought. Merging the codes to provide a generally more navigable codes landscape for newer entrants will help.

Further, licensing for code manager roles may not be an effective way to achieve accountability in the first instance. Presumably where a code manager does not abide by the strategic direction they will incur a fine. Would the fine accrue to the code panel, who currently support code administrators, or to the company? Were it the latter, there would be a mismatch between those ultimately incurring the fine and the motivations of the offence, which may be committed in line with a company's individual commercial interest.

February 2017

As identified, licensing of code administrators would require primary legislation. Ofgem has identified that, on the assumption that legislation is passed quickly this year, the first licenses could be issued in 2019. We believe that other procedures could be enacted faster than this, as detailed below.

Code and code manager/delivery body consolidation

The crux of Ofgem's argument is that coherent change is needed, and that this is difficult to achieve with diverse codes, administrators with diverse interests, and where policy changes necessitate modifications across multiple codes at once. If coherent change is needed, then coherent codes must surely be a means to achieving this. We are unclear why merging the codes is outside the scope of the consultation. Fewer codes would bring immediate coherence, fewer code modifications needed per policy change and fewer requirements (in terms of time and money) for parties to the codes, making them more accessible to new entrants. This solves several problems at once.

There are some obvious examples of compatible codes that could be merged (e.g. the D Code and the DCUSA, or the CUSC and the BSC), though more significant mergers could be envisaged. For example it is possible to envisage three codes: retail, wholesale and networks. The substance is the same, it is simply a question of how this is separated out. We understand Ofgem's proposals are not precluding code mergers in future, but disagree with the perception that this will be an organic rather than a top-down process. It is foreseeable that code administrators will not seek to merge the codes as it would reduce the 'market' for code management. Parties may only favour code mergers if they are likely to win the right to run them. Therefore, to the extent that merging codes could help solve the problems at stake, Ofgem should consult on consolidation of the codes as a legislated process.

We understand that the CMA identified code merging as a possibility, but did not prioritise it. However we also understand that the main contributor of evidence to the CMA's review, particularly on this subject, was Ofgem. We do not perceive that merging the codes would be a more difficult process than introducing licenses, for example, though there could be associated costs given the legal drafting required. Nonetheless, it may be possible to implement without the need for legislation, unlike licensing of code managers. We urge Ofgem to consult on merging the codes where appropriate.

Other considerations - the right to raise modifications

A key issue leading to the disenfranchisement of our members (and indeed parties with an interest in a smart, flexible energy system) is that you need to be a signatory to a code to raise a modification even where it has a direct impact on your business. It is difficult to get a modification sponsored by a party to the code where their commercial interest is not at stake. Of course it is important for balances to be in place so that only modifications of genuine concern are raised to prevent the system being clogged, yet more needs to be done to ensure innovative industry parties who are not represented can influence modifications that are being proposed.

There will be more benefit from broadening participation in the decision-making process, as it will bring a more representative industry view, leading to fairer competition and greater consideration of how the strategic change will enable a greater diversity of players in the industry. Ofgem should explore solutions for this. For example:

- There could be a **panel that accepts or rejects modifications raised by external parties**, which must tick certain boxes to be put forward (e.g. demonstrate a valid commercial concern). This function could be fulfilled by the consultative board.
- **All parties should have the right to appeal modifications to the CMA**, and appeals should be permitted or declined based on merit. The cost of this process would inhibit spurious appeals.
- There could be a category of **'interested parties'** to the codes (as opposed to signatories) - equivalent to a license lite - with an option to raise modifications where applicable. Some codes already allow external parties to attend meetings if relevant, while in others do not.

Box 1: Disenfranchisement of smaller parties in code modifications

In order to raise a modification to a code you need to be a signatory to the code. It is too expensive and complex for many new parties to participate, even where their commercial interests are at stake, as the sheer number of meetings they would need to attend and level of expertise required is unworkable for smaller businesses.

Even if they do participate, once a modification has been raised parties can only raise alternatives to the original proposal if they have attended enough work group meetings. Again, this is frequently too time-consuming for smaller companies and new market entrants.

Even then, the alternative modification would have to be based on the same defect. For example, with embedded benefits, it was outside the scope of the decision-making process to suggest that, while distribution connected customers could be getting over-compensated, another aspect of the problem could be that the capacity market is flawed. As another example, alternatives to CMP271 have been rejected not on merit but because they were not based on the originally-defined defect. This is a highly bureaucratic mode of governance.

In the embedded benefits review the work group voted the other way to the code panel. Further, the only party who voted in favour of EDF's modification were EDF themselves. This raises questions about the independence of the parties making the decisions.

There was no representation of distributed generation on the panel during the embedded benefits review. These modifications have a direct commercial impact on a huge variety of industry players (generators, demand-customers, electricity bills, consumers), but none of these were able to raise alternatives.

Other considerations - resourcing

As already identified, it is difficult for smaller companies and new market entrants to influence the codes, despite having a direct commercial interest at stake and despite, in many cases, their activity being central to Ofgem's strategic direction. In the past, spaces have been reserved on the code panels for representatives from distributed generation, however this has not addressed the resourcing asymmetry and parties have often been unable to attend due to lack of capacity. We are currently working with other trade associations to put forward representation to technical grid fora, but for the sheer number of grid fora and industry codes this will be insupportable to a satisfactory level. The resources required to engage with code governance tilts the system in favour of large incumbents.

February 2017

Furthermore, with the imminent implementation of the European Network Codes and further changes needed as the pace of change in the industry increases, resourcing code governance will be stretched even further.

Some of the solutions identified by Ofgem still do not take the asymmetry of resources into account, such as how to populate the consultative board in a representative manner, or how competition for tenders for code licenses will be fair. Ofgem has signalled that they want to set greater strategic direction in codes governance, but have not clearly signalled how the implementation of this will be resourced. One solution could be that if code managers are going to own the codes as licensed managers, they should be required to consider the impact on defined categories of key stakeholders of importance to the future system. However, this may not be enforceable or stringent enough. Another consideration is funding parties to represent smaller and distributed groups on the codes.

We urge Ofgem to think more carefully about how new entrants can be enabled to participate meaningfully in the code panel reviews going forwards as this will be the key to determining successful outcomes.