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By email only

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Dear Sir/Madam

Subject: Consultation on the Design and Delivery of the Energy Code Reform

Shell welcomes the opportunity to respond to BEIS and Ofgem's consultation on the design and delivery of Energy Code Reform.

We understand from the consultation document that there is an overriding concern that the code governance framework is complex, fragmented and lacks incentives to innovate. That the current code system was designed to deal with a more predictable energy system and incremental change and are not fit for purpose for the sheer scale of reform now needed – a more unified, flexible and dynamic approach – to ensure the energy system continues to benefit consumers and meet the UK's climate change proposals.

In considering the case for change it should be noted that the UK has been among the most successful countries in the developed world at cutting emissions, by 42% per cent since 1990, which is faster than any other G7 nation, while growing its economy, by two

thirds¹. In addition, in the 8 years since 2013 the domestic supply market share of the incumbent utilities has decreased from around 98% to around 55% and the number of suppliers has increased from 24 to 49 and peaked at about 70 in 2018². In its 2019 State of the Market Report Ofgem noted that there were 189 firms with a license to generate electricity and that the high number of companies entering and exiting the market suggests that any barriers to entry and exit are low and not a concern³.

Therefore, while we recognise many of the concerns set out by the Government and Ofgem in the consultation and agree with some of the remedies proposed – we do not agree that the existing code governance structure is insufficiently flexible to deliver transformative change or that it creates undue barrier to market entry. In our view the case for change set out in the consultation does not adequately reflect the existing rate of change in the industry.

As a result, we see benefit of rationalisation and prioritisation of the proposed reforms. In our view the most beneficial changes that could be made to address the concerns set out by BEIS and Ofgem in the consultation are to:

1. tidy up and consolidate code structures, which should also result in further harmonisation and streamlining of governance arrangements;
2. improve processes to ensure appropriate representation and involvement of new entrants, non-code parties and consumers in the change process; and,
3. for the Government – potentially together with Ofgem – to issue a Strategic Policy Statement or Strategic Direction which should cover both policy and governance issues.

Support for a Strategic Policy Statement while maintaining joint accountability

In addition, we do see a beneficial role for the Government – maybe together with Ofgem – in issuing a Strategic Direction or Policy Statement (we refer to both documents as a Strategic Direction). We consider that the Strategic Direction should encompass both policy and governance objectives for the codes, and that a mechanism should be

¹“The Clean Growth Strategy

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/700496/clean-growth-strategy-correction-april-2018.pdf

² <https://www.ofgem.gov.uk/energy-data-and-research/data-portal/retail-market-indicators>

³ <https://www.ofgem.gov.uk/publications/state-energy-market-2019>

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established to ensure that decision making in the code framework is accountable towards that Strategic Direction. In relation to governance, the scope of the Strategic Direction could also include consolidation of the codes.

We believe that a Strategic Direction, setting a clear and sufficiently granular policy intent will also enable more efficient decision making at code level. In our experience, one of the main issues that tends to slow decision making in code processes is a lack of sufficiently granular direction from the Government or Regulator. Where the Government and Regulator have provided clear and granular direction, such as the Smart Systems & Flexibility Plan⁴, we have seen GB implement new provisions to (in this case) remove barriers and enable the deployment of electricity storage faster and more effectively than most other countries.

However, it will be equally important that any Strategic Direction is not set as an infallible view of the world. There have been occasions, for example in Significant Code Review processes, or in seeking to implement a high-level policy steer that it becomes clear in the detailed discussions on code implementation that certain critical implications have been overlooked. At these times it is important that the decision-making process at code level can provide this feedback to policy makers so that they may consider whether the Strategic Direction should be updated and amended as a result.

Our main concern with the proposals set out in the consultation is that they appear to significantly weaken, or remove, any responsibility or accountability of industry in future network code governance and decision-making processes – and to replace the existing accountability of industry with a combination of Ofgem and the code managers. We believe that the best outcome for consumers would be delivered through either (or both):

1. the existing approach to code governance, reinforced with a Strategic Direction issued by the Government, which set both policy and governance objectives (i.e., code consolidation, participation of non-code parties etc.); and,
2. joint accountability between Ofgem and Industry for code governance and decision making.

⁴ <https://www.gov.uk/government/publications/transitioning-to-a-net-zero-energy-system-smart-systems-and-flexibility-plan-2021>

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Our preference for joint accountability is set in a belief that there is simply too much to do, and too much at stake, for one party to assume full responsibility and accountability. We support Ofgem taking a more active role and for Ofgem to be adequately resourced for that more active role. However, we believe that more thought should be given to how best to establish governance mechanisms that deliver joint accountability and responsibility – and that both licensing and tendering may not necessarily be the best mechanisms to deliver this.

We do not see the need to establish an additional layer of Governance between the Strategic Direction and the code bodies. We believe that, subject to there be an appropriate level of consolidation and streamlining in code governance arrangements, the most effective approach will be for the existing code governance arrangements to establish and set out how the relationship between the Strategic Direction and existing code decision-making processes. This could include annual reporting on progress in achieving that Strategic Direction to ensure full transparency.

It remains to be seen whether Ofgem tendering or market-based approach to selecting code managers is in the interests of consumers. If Ofgem adopts a tendering approach we believe that any key performance indicators, decision making criteria, or key contractual obligations linked to performance of the winning code manager should be made public. In our view making this public would reinforce joint accountability of Ofgem and industry by also enabling industry parties to hold code managers accountable against those KPIs.

Finally, it is also not clear how a tender process to select a code manager, and the subsequent contractual basis for delivering those functions, would then sit alongside a potential licensing regime. We do not currently support the proposed licensing regime as we believe that maintaining code panels and enabling joint accountability to Ofgem and industry will be a more effective and flexible approach to delivering change.

Greater inclusion of non-code parties and consumers in decision making

In relation to participation of non-code parties, we agree that there is significant scope to improve governance processes to ensure greater involvement of new entrants, non-code parties and consumers in the change process. This will also need to be balanced against cost sharing arrangements. For example, there may be commercial entities that are able to benefit from proposing code reforms, but do not have to bear any of the costs associated with those system changes. We do not consider this to be fair. Setting

objectives for participation of non-code parties in code governance could be included in the Strategic Direction.

Maintaining code panels and fair and reasonable routes to challenge

Shell does not support the proposal to disband industry panels. In our view industry panels work reasonably well as an approach for industry to have appropriate oversight, responsibility and accountability in the code decision making processes. Much of the expertise around the codes sits with industry and independent code panellists and is vitally important to ensure this expertise remains visible and at the core of the code process.

There needs to be greater recognition that the codes are multi-lateral contracts that code parties have to comply with to participate in the energy market they are not normal commercial contracts. Code parties cannot walk away, without exiting the market whilst Code Managers can. We believe that panels should be retained, with membership and roles reviewed to ensure:

1. better representation of industry parties, non-code members and most importantly consumers
2. a more consistent approach to code governance delivered alongside a degree of code consolidation; and
3. appropriate checks and balances and reporting obligations to ensure adequate reporting and progress in implementing any Strategic Direction.

It is also vital that code parties can appeal decisions made by Ofgem irrespective of whether the decision aligns with the recommendation of the code manager. This is to ensure good governance which requires separation of roles and responsibilities, with appropriate checks and balances and transparency of process.

It is important for the industry to be able to challenge both the context and process of the decision. This means that appeal routes to both the CMA and by judicial review should be available to industry. Appeals of this nature are not frequent nor are they pursued lightly as they are resource intensive for the parties involved.

Yours sincerely,

Olaf Islei
Senior Manager UK & EU Power Regulation