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Dear Lesley,

Design and Delivery of the Energy Code Reforms

Thank you for the opportunity to comment on the issues raised in your consultation on the design and delivery of the energy code reforms. Our responses to the specific questions raised are set out in the annex to this letter. We would highlight the following points:

- **The role and rights of code signatories/parties** – We disagree with the proposed transfer of accountability for change proposals and code performance and costs solely to the strategic body and code managers. Code parties bring valuable industry experience and expertise to bear in their scrutiny of change proposals, performance assurance etc, and none of Ofgem's proposals will be able to replicate this. In the context of the wider reforms, we have seen no evidence in the consultation or impact assessment to demonstrate that the abolition of code panels and code budget scrutiny by code parties will deliver any material benefits. This is a new development since Ofgem's 2019 consultation and there is no reason why code managers could not be jointly accountable to a strategic body/function and code signatories and other interested parties. Even if it was a material issue (which we doubt), the ability of code parties to frustrate reform and government policy objectives should be mitigated by the creation of the Strategic Body – as was previously proposed in 2019 and earlier.
- **Appeal of strategic body decisions** – We disagree with the proposal to remove existing routes of appeals on change proposals to the Competition and Markets Authority (CMA). Judicial review is not a substitute for a review on the merits by the CMA and removal of this route of appeal will harm investor confidence in the sector at a time when new investment is critical to delivering Net Zero. It would be straightforward to include a right of appeals to the CMA in the primary legislation required to establish the Strategic Body.
- **Options for reform** – We consider the option of a separate strategic body/function and code managers is the only viable option for delivering code governance reforms and we agree this should be the preferred option. We believe the integrated rule making body (IRMB) whether undertaken by the future system operator (FSO) or any

other organisation will be inefficient and lack transparency and therefore this option should not be considered going forwards.

- **Code consolidation** – The progress of the Retail Energy Code (REC) to date demonstrates that a well-designed code consolidation scheme is one of the key drivers of successful code reform implementation. In this context, it is important that sufficient time is given to this phase of implementation so that the scope for code consolidation can be considered and optimised to ensure the resultant governance architecture is as efficient as possible.

If you have any comments or queries on any aspect of this response please do not hesitate to contact me or Haren Thillainathan (hthillainathan@scottishpower.com, tel.0141 614 2007).

Yours sincerely,



Richard Sweet
Head of Regulatory Policy

**DESIGN AND DELIVERY OF THE ENERGY CODES REFORM
– SCOTTISHPOWER RESPONSE**

1. To what extent do you agree with our proposals for the licensing of a code manager for the in-scope engineering standards and why?

Aspects of the proposals remain ambiguous and we do not completely agree with them. In general, we support the principle of coordinating changes to in-scope engineering standards but there are elements related to decision-making, potential conflicts of interest and checks and balances that remain unclear.

Decision-making

Engineering standards specify how the physical electricity and gas network must be built, maintained and operated within strict safety, security and engineering standards. They are necessarily complex and require decision-making frameworks that are underpinned by sufficient expertise, experience and depth of knowledge to avoid unintended consequences.

The consultation assumes that both the strategic function and Code Manager (CM)(s) will be able to up-skill promptly, secure resources and transfer knowledge to form a competent decision-making framework. Limited consideration is given to the practical risks of starting up new functions, lead times for business transformation and preserving technical knowledge in the process of transferring decision-making capabilities from industry to these central functions.

The proposal to allow CM(s) to propose changes and make decisions on non-material code changes introduces a risk that the entity becomes a single point of failure in the system. The obligation on the CM to consult with stakeholders assumes it will be able to access industry expertise, possess the requisite skills to assimilate technical feedback and have the capability to drive best practice. There is insufficient information in the consultation to understand how CM(s) would achieve this effectively.

There is also an assumption that the strategic function will be effective in monitoring compliance and driving performance through the CM licence. Given that both the strategic function and CM will be taking on new responsibilities, it is possible that both functions may experience teething problems and would, to a degree, be subject to on-the-job learning. The consultation does not offer any insight on how the maintenance and oversight of technical codes will remain resilient during the start-up phase or what contingency measures will be adopted should the functions experience unforeseen or sustained performance issues.

The CM would under Option1 have the powers to propose code changes and take decisions on non-material code changes. It is unclear in this consultation what constitutes a non-material change. In the event that non-material code changes form the majority of events, the risks above would become more acute.

Conflict of interest

Having the responsibility for meeting its Delivery Plan and the authority to prioritise code modification applications creates a conflict of interest. There are no safeguards mentioned in the consultation to ensure the CM acts with due diligence if a backlog of modification applications begins to materialise. Modifications to technical codes can be complex and

demanding. It is important to avoid a perverse incentive to deprioritise them or truncate checks for unintended consequences.

In addition, any objective to consolidate and simplify codes may not be as straightforward for technical codes. Prescription within codes is there to instruct a technical audience so losing detail or over-simplifying these codes may be counterproductive. It is unclear in the consultation whether the CM is accountable for preserving the right level of technical detail against an objective to simplify codes.

Checks and balances

As far as the SQSS and GC are concerned, costs arising from code modifications have always been considered reasonably fairly, eg by not applying changes retrospectively or by fixing an implementation date sufficiently far in the future. It is unclear whether the CM will have an obligation to consider the resulting costs on code parties from a change to technical codes.

Also, for the SQSS, the DNO licence has always been tied to a particular version of the document. It is part of the reason why the change process takes time (multiple consultations are required before the SQSS change comes into effect). This iterative process builds in multiple checks before a code change might result in a DNO breaching its licence. Derogations can be issued in these circumstances, but the consultation does not explain how derogations will be dealt with or the capacity of a CM to manage them. It takes time and resources to fix a technical issue so derogations are a necessary safeguard, as is the capacity for a CM to issue and manage them.

2. What are your initial views on how central delivery system bodies should be regulated (including their relationship or integration with code managers and the extent licensing may be appropriate) bearing in mind this may be a subject for future consultation?

We have reservations with certain aspects of the currently proposed role of licensed code managers (see our response to Q4). However, to the extent they are introduced, we believe code managers should have “end-to-end” process responsibility including for central delivery systems. The experience of having separation of UNC as administered by the Joint Office and Xoserve responsible for the delivery systems has led to sub optimal outcomes notably the delivery of Project Nexus. Subject to our suggested amendments to the role of code manager, we think they should where applicable, comprise the relevant code administrator integrated with the relevant central system delivery body and subject to a single licence.

We support the suggestion that further system delivery functions could be brought into scope, particularly the Central Switching System. This will allow greater transparency, including on costs.

3. To what extent do you agree with the proposed roles for the strategic functions set out above and why?

Yes, we agree there is at present effectively a lack of strategic oversight of industry codes and a coordinating body to steer through wider government policy objectives, eg achieving net zero by setting a strategic direction. Accordingly, we agree that reforms are required to the institutional architecture with a view to creating a more effectively constituted strategic function. We believe it would aid accountability to set out the Strategic Function’s objectives directly in primary legislation.

It is reasonable to argue, however, that Ofgem could have performed the role of the strategic function, but has largely failed to do so to date, most notably by not engaging sufficiently with code governance processes to guide change proposals. While we agree that the preferred option should be Ofgem assuming the role of strategic function, it is important to recognise that this will require a significant step up in performance in how Ofgem engages with industry codes.

The strategic function will be required to publish a strategic direction annually. The expected content of the strategic direction does not include a consideration of costs and risks associated with the strategic function's view on which codes may need changing. We believe it should as such costs would, to a degree, filter through to customer bills.

It is anticipated that the strategic direction will vary from year to year depending on the extent of developments since the previous strategic direction. The consultation states that, *'Publishing the strategic direction on a yearly basis would ensure that codes change in line with wider strategic plans and would allow market participants to implement their work in line with this'*. There are several risks associated with this approach:

- CMs would be required to publish delivery plans after each strategic direction. The consultation period for delivery plans and the lead time needed for code parties to react to code changes will compress implementation timescales within annual iterations of the strategic direction. In essence, there could be multiple ongoing code changes associated with previous versions of the strategic direction. This will require careful coordination to avoid stranded costs (if, for instance, a change from a previous strategic direction has to be amended in some way).
- The consultation also notes that the strategic function would be required to consult with 'specified stakeholders' before publishing the strategic direction. We believe it should be an open consultation to ensure that code parties have early sight of potential changes.

4. To what extent do you agree with the proposed roles for the code manager set out above and why?

We do not support the additional change to the proposed role of the code manager introduced after the 2019 consultation, namely that they assume the functions and responsibilities of code panels. We do not believe this latest consultation has provided any evidence to justify the abolition of code panels and associated code governance such as performance assurance bodies. Specifically, the consultation provides no justification in the context of the introduction of strategic function/body and code managers, of why the continuation of code panels would in themselves prevent or impede key reforms or government policy objectives being implemented. Code panels are now largely balanced in membership, including consumer bodies and smaller companies, in addition to being independently chaired and therefore we think that given the other proposed reforms, the potential for code signatories to subvert reform is overstated and does not justify the abolition of the panels.

The proposed enhanced roles of code managers leave them with no accountability to code signatories and other interested parties in respect of the viability and quality of change proposals and the performance and costs of code managers. This essential scrutiny and challenge is currently provided by code panels, drawing on the industry knowledge and expertise of their members. While code managers will remain accountable to the strategic body, we think the latter is unlikely to have the resources to make up for the lack of oversight due to the abolition of code panels. We think the proposed stakeholder forums are an inadequate replacement for panels and the currently proposed appeals on code manager

decisions will be insufficient to remedy the above problems. We are not convinced the impact assessment has taken account of the increased costs of rectifying unworkable or lower quality change proposals, plus the increased inefficiency of code managers that is likely with loss of code panels.

Notwithstanding the above points we have two further concerns with the proposed role of code managers:

- We believe there is no justification for code managers having the ability to propose or raise change proposals. To date there have been almost no examples where code administrators have not been able to find a code signatory to raise a change proposal. If code managers were to be given this ability, it should be tightly defined so it could only be utilised in specific circumstances. For example, such powers could be limited to scenarios where code managers have demonstrably been unable to find a code signatory to raise a change proposal required to implement the strategic direction. Without this safeguard there is a reasonable risk code manager could be motivated by self-interest to raise change proposals.
- We don't believe code managers should decide on whether to approve change proposals. The strategic body should be required to approve change proposals related to the strategic direction and other more important changes. Remaining change proposals would be self-governance by definition and should remain with code panels for approval. The code manager's focus should be the management and development of change proposals and their prioritisation. Decision making on changes by code managers simply introduces unnecessary conflicts.

5. To what extent do you agree with the proposed roles and responsibilities of stakeholders as set out above, including the role of the stakeholder advisory forums and why?

As set out in our response to Question 4 we do not agree with the proposed role of stakeholders, in particular, the loss of rights of existing code signatories and the abolition of code panels.

We believe the proposed stakeholder advisory forum is a wholly inadequate replacement for code panels especially as it is proposed that their composition and role is purely at the discretion of the code manager.

6. In relation to option 1, where Ofgem would be the strategic body, to what extent do you agree with our proposals on how decisions by the code manager would be overseen by the strategic body with, as a minimum, existing appeal routes retained and moved to the strategic body?

We believe at minimum, the proposed oversight of the strategic body of code manager decisions must be accompanied by appeals processes against code manager decisions including decisions:

- to raise or progress a change proposal;
- on the materiality of and prioritisation of change proposals;
- to recommend a change proposal or approve a [non-material] change proposal.

It is also unclear on what basis the strategic body would conduct oversight of the code manager's operations and budget; this is currently overseen by code signatories or their representatives. There should be a mechanism for code signatories to escalate challenges to poor performance or material cost increases by code managers to the strategic body. This should be regarded as a minimum requirement as these costs are borne directly by code signatories. We note in Chapter 5 there is mention of a licence obligation on code managers to allow stakeholder scrutiny of their budgets. No further details are provided but we understand there will be further consultation on this.

7. In relation to option 2, where the FSO would take on the role of the IRMB, to what extent do you agree with our proposals on how relevant decisions by the code manager function would be appealable to Ofgem, with a potential prior review route via an internal body?

We only agree with option 1, ie separate code manager(s) and strategic function/body. We consider option 2, the integrated rule making body (IRMB) which combines the strategic function will offer reduced accountability, reduced transparency of responsibilities and is much more likely to be inefficient. Accordingly, we agree option 1 is the preferred option and we do not offer further comment on the merits of option 2.

8. Do you have any views on the two proposed options for appealing decisions made by Ofgem on material code changes in option 1 (with Ofgem as the strategic body) and option 2 (with the FSO as the IRMB)?

The two proposed options are:

- a) all strategic body decisions are only appealable by judicial review;
- b) Strategic Body decisions are appealable by a combination of JR and referral to the Competition and Markets Authority (CMA).

In our view, only the second option (which reflects current rights of appeal) is acceptable. We believe it is essential that the strategic body's approval decisions can be appealed for a merits-based review to the CMA as is currently the case for Ofgem's code change proposal determinations. Removal of this route of appeal will harm investor confidence in the sector at a time when new investment is critical to delivering Net Zero.

We note the comments about aligning the CMA change proposal appeal process to that for licence modifications. We will await further details on these aspects before commenting on their appropriateness. We accept that primary legislation will be needed to allow appeal of strategic body decisions to the CMA, however legislation will be needed regardless to establish the strategic body, so we don't consider this a material consideration against option 2.

9. Do you have thoughts on other potential appeal routes?

No.

10. To what extent do you agree with the proposed operating model and accountability structure for Ofgem as Strategic Body and why?

We agree the accountability for discharging the strategic body's functions should be to the existing Gas and Electricity Markets Authority (GEMA) board. With regards to the organisation and resourcing of the strategic body within Ofgem, it is reasonable to argue that historically Ofgem could have performed this function and has largely failed to do so. One key reason for this failure is Ofgem not engaging sufficiently and early enough with code governance processes to guide change proposals. It is therefore important to recognise that Ofgem assuming the role of strategic body will require a significant step up in performance in how it engages with industry codes.

11. To what extent do you agree with the monitoring and evaluation approach for Ofgem's performance as the strategic body, and why?

We agree with the overall proposal for monitoring and evaluation to be in line with the 2019 framework document on the relationship between BEIS and Ofgem¹.

12. To what extent do you agree with the ways we propose that the strategic body selects code managers, and why?

We believe appointment by tender is generally regarded as best practice for awarding service contracts such as code managers. Such approaches could be made more flexible with the ability to tender code manager service areas, eg performance assurance, project management etc. either individually or collectively. We believe Ofgem should review and adapt standard commercial tender processes to ensure they don't preclude not-for-profit organisations which could, for example, find standard liability cover requirements prohibitive.

We note the intention in Chapter 5 to allow the strategic body alternative options to tendering to appoint code managers. We would expect these options to be used only in exceptional circumstances and this should be clearly defined in the relevant legislative provisions.

13. To what extent do you agree with our proposed approach to code manager funding, and why?

While we don't disagree that the costs of code managers should be funded by code parties/signatories we believe this should therefore be accompanied by the accountability of code manager to code parties which we believe could be a joint accountability to the strategic body.

14. To what extent do you support our proposal that the strategic body should be accountable for code manager budgets, and why?

The details in Chapter 5 on how the strategic body would discharge its accountability for code manager budgets are vague. We note the intention to consult in detail on this area, so we will reserve judgement until then. That said, we are not convinced that, in the absence of code party views, the strategic body, ie Ofgem, will be able to provide effective scrutiny and challenge on the budgets. As set out in our response to Question 6, we believe code

¹https://www.ofgem.gov.uk/system/files/docs/2019/12/framework_document_final_publication_version_december_2019.pdf

parties/signatories should be allowed a role in budget scrutiny and have associated rights of appeal on this.

15. To what extent do you support the proposed operating model and accountability structure for option 2, where the FSO takes on the role of the IRMB, and why?

We consider option 2 (integrated rule making body (IRMB) which combines the strategic function) will offer reduced accountability and reduced transparency of responsibilities, and is more likely to be inefficient. Accordingly, we agree that option 1 (separate strategic body and code managers) is to be preferred and we offer no further comment on the merits of option 2.

16. Overall, which of the two options do you think would be best placed to reform code governance, and why?

We think the preferred option 1 is best suited to delivering code reforms for the reasons given in our response to Question 15. We agree with the statement that the FSO would have little to no knowledge or understanding of the retail markets, and as such Ofgem is better placed to carry out this role.

17. To what extent do you agree with our estimated costs for the new code manager function set out in the impact assessment, and why?

Now that the Retail Energy Code has been established, we believe a period of a year should be allowed for monitoring the success of the new code, including how cost-effective it is. To date we have concerns that the expected benefits may not be achievable and, as such, we are reluctant to see more codes established. We are comfortable with the Ofgem impact assessment but have concerns with the use of Elexon's estimate as the current REC budget on its own is approaching £30m per year. The current code set-up allows the industry to benefit from subject matter experts within individual companies via the use of expert groups and open discussions. The proposal to use the Code Manager to drive this removes this ability and risks stifling new ways of thinking or working.

Further, with the current price cap and other pressures on suppliers, we strongly disagree with a potential increase of £35m for a limited £2m potential benefit. We would recommend a staggered implementation, with Ofgem becoming the strategic body first, allowing more time for the analysis of the success or otherwise of the REC Code Manager model. This could also potentially allow for the Code Manager model to be implemented alongside code consolidation, as has happened with the REC.

With regard to the IRMB option, we believe the costs do not include new recruitment or use of consultants to fill the knowledge gap on retail markets and processes. We would expect considerably higher upfront and ongoing costs.

We would also note that costs have been based on the historic average number of code changes per annum. However, one of the drivers for change was that the modification process was not sufficiently agile or quick, so it is possible that the actual number of modifications may be greater than assumed.

Given the reduced level of direct industry involvement in the development of modifications and their solutions, there may actually be an increase in costs associated with the code consultation process as this will be the only opportunity to provide feedback on a proposed

modification and its implications, which makes this a much more important step in the process for industry.

18. To what extent do you agree that the case studies included in the impact assessment are indicative of the major barriers facing code changes under the current system, and why? Can you provide further examples of when current code governance has resulted in either optimal or sub-optimal outcomes?

We do not agree with the use of P272 as a case study. P272 increased customer costs and forced them to take up additional contracts for metering and data for very limited or no benefit to them. The Modification had considerable benefits stated but these have not materialised to date. Further, a number of operational issues were well documented before P272 was raised. Instead of resolving these issues they were ignored, with customers and settlements impacted as a result. One of the issues was finally resolved only by the industry working together to find a resolution.

We would recommend that P379 is used as a case study instead as it clearly demonstrates the benefits to the industry as a whole of scrutiny by industry panels and expert groups. The modification was linked to Elexon's white paper and was raised in March 2020 with support from Ofgem and Elexon, who commended the proposal for being innovative. Industry Panel members expressed reservations about costs, as can be seen in the Panel Minutes. In May 2020, Industry Panel members instructed Elexon to engage an independent Cost Benefit Analysis (CBA). In April 2021, the consultants, CEPA, presented their CBA to the Panel, concluding that there was insufficient certainty of benefit to outweigh the certain costs of implementation, with the result that the proposer withdrew the modification. This clearly demonstrates the benefits of industry panels and experts as a checkpoint to ensure that costly, ineffective changes are not implemented. P375 was raised by the industry in December 2018 and proposes to resolve all the issues raised by P379 in a concise, practical way. We believe the progression of this Mod was hampered because of the incorrect focus on P379.

19. To what extent do you agree with the scale and type of benefits to industry estimated in the impact assessment? Are there further cost savings to industry that should be included?

As noted above, we believe industry experts who attend industry panels and expert groups are a benefit to the industry, not just the companies or groups they represent. Removing them completely can only harm the industry as costly, incomplete or ineffective changes are more likely to be taken forward by Code Managers who do not actually operate in the market they are trying to change.

We would recommend that all Code Managers and Codes are set up in a way that means they are run not for profit, as DCUSA, MRA and SPAA have been run in the past. Allowing Code Managers to drive changes allows the potential for them to directly impact the Code's budget.

More generally, the scale of the benefits appears to be outweighed by the costs of establishing the Strategic Body and Code Management function, and it is therefore difficult to reconcile the significant changes being put forward to the level of benefits to be gained. The assessment appears to assume that only benefits will accrue to industry parties and no additional costs (or reduced benefits) will be seen. This may or may not be a valid assumption as there may be additional work for industry to undertake more rigorous analysis or legal review of proposed solutions, which would previously have been captured during work group discussions and collaborative development of solutions.

The current cost recovery arrangements are to pass the costs on to licensees (or a subset of licensees) which means that not all Users (or beneficiaries of the changes) will be impacted by the costs of changes being proposed. This may create a perverse incentive for Code Managers or industry parties to create additional modifications as they will not be directly impacted by additional costs that are created.

20. Are there any other wider industry developments we should consider in relation to the implementation timeline? How do you think these could impact on code reform?

As noted above, we believe the first year of operation of the REC should be monitored to establish if it has driven the expected benefits for the industry. We would be concerned about using it as the precedent when it has only just been implemented. For example, the change process appears to be slower than the MRA and SPAA change processes.

We would also recommend a review of Government and Ofgem large scale supply industry changes to establish if the predicted benefits have been achieved. For example, the faster switching programme has not led to any reduction in systems or flows, which means the industry will still be extremely complicated for new entrants. This could have been an opportunity to remove the need for MPAS or Xoserve but the opportunity was not taken.

Other BEIS/Ofgem initiatives including the OTNR, FSO and emergency restoration code projects need to be factored in (as well as existing code modifications in progress) as these are utilising a relatively small pool of resource to progress deliverables in interrelated areas.

21. Are there any implementation issues, risks, or transition considerations we should take into account? How could these impact code reform?

We think the high-level implementation scheme set out in Chapter 8 has identified the correct broad phases and these will require further consultation and development to identify the key risks and details critical to successful implementation of the reforms. As we have seen with the REC, design and scheduling of the consolidation of the codes in scope will be an important driver of the overall implementation programme, and it is important this is given sufficient time to design an optimal consolidation scheme. This approach will deliver long term benefits by ensuring the resultant code governance architecture is as efficient as possible, thereby minimising costs to consumers and enabling timely code change and reform delivery.

22. We invite respondents' views on whether our proposals may have any potential impact on people who share a protected characteristic (age, disability, gender re-assignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex or sexual orientation), in different ways from people who do not share them. Please provide any evidence that may be useful to assist with our analysis of impacts

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23. Do you have any other comments that might aid the consultation process as a whole?

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Scottishpower
September 2021