



# Codes Governance and Reform Discussion Paper

IGov Team, Energy Policy Group  
University of Exeter

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## 1. Context

This discussion paper summarises some of the key points that were raised at a recent cross industry workshop run by the Energy Policy Group on the future of gas and electricity code governance in October 2015. More details of the event are available on the [IGov website](#).

Energy industry codes are the technical and commercial rules that sit at the heart of the energy system in Great Britain. Codes are incorporated into standard licence conditions for generators, network companies and suppliers. In total there are 17 different codes for gas and electricity,<sup>1</sup>. Ofgem (2015a:2) defines codes as ‘*the contractual arrangements that underpin the operation of the electricity and gas industry*’. As a result they influence the way companies act within the market and many aspects of codes therefore have significant commercial implications. Network actors are also required to use the appropriate technical standards documents for network planning and operation. It is possible for companies to depart from what is specified in technical codes and standards, but to do so they must seek derogation from Ofgem.

Compared to high-level energy policy, codes are rarely debated publicly, and they remain largely invisible to those outside the industry. But because they define the terms under which participants can access networks and operate in markets they actually play a critical role in determining how far energy systems are able to realise the trilemma goals of sustainability, security and affordability.

For any aspect of energy policy to function well, regulation including industry codes must be sufficiently aligned with that policy. A good example of why this alignment is important is the situation that arose in the 2000s with the rapid growth of wind power, especially in Scotland. The expansion of renewable energy was a high-level policy objective for the UK. Transmission Owners (TOs) are subject to price controls, part of which considers upcoming connections to their

network. Under licence, TOs and the System Operator (SO) must agree a 10 year Network Plan. These two elements highly influence renewable generation connections, and any changes to the process for delivery filter down to codes.

Existing rules on connection to the transmission network in the Connection and Use of Services Code (CUSC) specified that connection could not be made until any necessary reinforcement work in the wider network had taken place, an arrangement known as ‘Invest and Connect’. This approach led to long delays in new wind power projects being able to connect and start generating. A number of different attempts to change the CUSC were made, many of which were rejected within the narrow objectives of the code, and eventually in 2007 the government stepped in and undertook a review of transmission access.<sup>2</sup> In 2010, a new approach was brought in by government, in which wind farms were connected ahead of any necessary reinforcement work, with the system operator managing any constraints, i.e. ‘Connect and Manage’. In this case, code governance failed to solve the problem and direct government intervention was needed, but there was a significant delay between problems arising in the early 2000s and the solution being reached.

Thus the central overarching issue for codes is how they can keep up with the major changes in energy, especially electricity. As one supplier put it recently, the content of codes ‘was created at the dawning of the energy market when big power stations and big companies dominated. Little of it anticipated a world where decentralised technologies such as wind and solar would be producing 24% of the UK’s electricity.’<sup>3</sup> Energy industry codes in Britain were established at various times over the last 20 years. Commercial codes, covering contractual relationships between energy industry actors, were established during the process of privatisation,<sup>4</sup> while the technical codes covering the operation and planning of networks and power plants have their origins in the pre-privatisation post-War period.<sup>5</sup> But the energy system is now seeing the rapid development of intermittent renewable electricity generation, decentralised production of both heat and electricity, a much greater role for demand side flexibility and the much wider use of ICTs in energy systems. To capture the benefits of change and to minimise the costs of transformation, it is necessary that industry codes change at the same rate as the energy industry. As the CMA puts it:

*‘The GB energy industry is undergoing a period of significant change, driven not only by the need to tackle climate change but also by factors such as technological development (for example, the smart meter agenda and the development of demand-side response technologies). In order for industry and consumers to capture the benefits of change and*

*minimise the costs of transition, it is necessary that industry codes develop at the same rate as the energy industry.’ CMA (2015c: 461)*

**Table 1: Energy industry codes and standards in Great Britain**

| <b>Area</b>                               | <b>Title</b>  | <b>Description</b>   |
|---|---|--|
| <b>Electricity distribution</b>           | Distribution Code (D-Code)                                  | Technical parameters relating to the planning and use of electricity distribution networks   |
|   | Distribution Connection and Use of System Agreement (DCUSA) | Covers commercial aspects of use of electricity distribution network services  |
| <b>Electricity transmission</b>           | Connection and Use of System Code (CUSC)                    | Framework for connection and use of high voltage transmission system and certain balancing services  |
|   | Grid Code   | Technical aspects relating to connections, operation & use of transmission network   |
|   | System Operator/Transmission Code (STC)                     | Defines the relationships between National Grid as system operator and transmission owners   |
| <b>Electricity balancing</b>              | Balancing and Settlement Code (BSC)                         | Sets out rules for participating in Balancing Mechanism and for settling energy imbalance  |
| <b>Electricity retailing</b>              | Master Registration Agreement (MRA)                         | Rules for retail market processes including electricity registration, change of supplier processes and the Green Deal  |
| <b>Gas transmission and distribution</b>  | Unified Network Code (UNC)                                  | Defines the rights and responsibilities for users of the gas transportation systems, and provides for all system users to have equal access to transportation services         |
| <b>Gas retailing</b>                      | Supply Point Administration Agreement (SPAA)                | Sets out the inter-operational arrangements between gas suppliers and transporters in the UK retail market   |
| <b>Gas and electricity smart metering</b> | Smart Energy Code (SEC)                                     | Defines the rights and obligations of energy suppliers, network operators and other relevant parties involved in the end to end management of smart metering in Great Britain. |

Source: Licences, Code and Standard documents

## 2. History of reform efforts

At the heart of this challenge of modernising codes is the issue of **code governance**. The basic principle up until the late 2000s was largely one of self-governance. Changes to codes (often called ‘modifications’) were overseen by a panel or similar body made up mainly of representatives from the energy industry itself, with a code administrator running the change process day-to-day and reporting to the panel. After assessing change proposals and consulting

industry, the panel would then put a recommendation to Ofgem, which made the final decision and published a rationale for that decision within the terms of its duties.

In 2007, a major review of code governance was initiated by Ofgem.<sup>6</sup> This review was driven by two concerns: problems in amending codes to support the delivery of major reforms in key policy areas, especially to meet the low-carbon imperative, and the fragmented and complex nature of code processes which made it difficult for small suppliers and renewable generators to participate fairly and effectively.<sup>7</sup> The Code Governance Review ran from 2008 to 2013 and introduced three major reforms:

- The existing modification process added **two new routes** for changing codes: a fast-track 'self-governance' route for minor modifications with 'non-material' impacts which would not require Ofgem approval, and the Significant Code Review (SCR) in which Ofgem would instigate changes to align codes with the requirements of high-level policy. In an SCR Ofgem would prepare the ground by carrying out analysis of changes needed and their likely impacts, but still had to rely on an industry party to raise a modification on its behalf.
- The introduction of a Code Administration Code of Practice (CACoP):<sup>8</sup> a non-binding set of principles and processes that code administrators were expected to follow with the objective of **standardising practices across codes and making change processes more transparent**. The CACoP specified that code administrators should act as 'critical friends', meaning that they provide support to all parties, but pay 'particular attention to under-represented parties, small market participants and consumer representatives'.
- A requirement in BSC, CUSC and UNC licence conditions for panels to make an assessment of **the carbon impact** of a proposed modification where appropriate.<sup>9</sup>

These changes have had an impact on the governance of industry codes. However, despite the CGR many of the underlying problems persisted, and in the last 18 months two further reviews of code governance have been launched: (i) a consideration of codes in the 2014 energy market investigation being undertaken by the Competition and Markets Authority (CMA),<sup>10</sup> and (ii) a further review by Ofgem in 2015.<sup>11</sup> These reviews are attempting to address a range of issues, many of which are the same as those raised in the original Code Governance Review in 2008,<sup>12</sup> including:

- The length of time it takes to make changes to codes, especially the major changes made through a Significant Code Review
- The difficulty of making and coordinating changes that involve more than one code
- Change processes lacking the *vires* to ensure codes reflect the transformation facing the industry
- Present and future consumer interests not sufficiently considered in change processes

- Code objectives not aligned with Ofgem’s duties
- The sheer complexity of codes themselves
- The large numbers of meetings that actors have to attend to track code changes
- Minor changes are still going to Ofgem for final approval
- Governance arrangements, collateral requirements and levels of service by code administrators vary across codes
- Incumbents (Big 6 suppliers vertically integrated in electricity, the major distribution network operators and National Grid) dominate panels, working groups and in some cases voting.

The focus of the CMA investigation is on competition and the welfare of consumers. It has reached a provisional conclusion that despite reforms under the CGR, code governance arrangements can lead to ‘inconsistent or delayed outcomes’ for code change and creates ‘material burdens’ on industry actors, especially smaller ones, all of which are creating an adverse effect on competition.<sup>13</sup> The CMA is proposing three possible ‘remedies’. These all relate to the relationships between bodies within the code governance set-up:

- Make code administration and/or implementation of codes changes a **licensable activity**. This reform would allow Ofgem to monitor performance, give directions, and impose sanctions, with the aim of producing more consistency across codes and accelerating code changes, especially cross-code changes.
- Grant Ofgem more powers to **project-manage and/or control timetable** of the process of developing and/or implementing code changes. This reform would complement existing SCR powers and is aimed at enabling Ofgem to ensure that mod proposals that further consumer interests are implemented in a timely and efficient way.
- Appointment of an **independent code adjudicator** to determine which code changes should be adopted in the case of dispute. This reform is aimed at resolving disagreements more quickly. The adjudicator would need to take on Ofgem’s powers to approve/refuse modification proposals in these cases, plus extra powers to project-manage and/or control timetables.

Ofgem’s further review of code governance takes account of the CMA process, and is aimed explicitly at incremental improvements to the reforms introduced through the earlier CGR. Launched in May 2015, the review published Initial Proposals in October 2015.<sup>14</sup> It proposes changes in four areas:

- Significant Code Reviews: a new power for Ofgem itself to lead the process of major code revisions from start to end, including **the power to raise modifications itself**. In the instance that Ofgem directs an industry code member to raise an SCR modification it can

set a timetable for it to progress to a recommendation. This proposal clearly overlaps closely with the second of the CMA reform ideas.

- Self-governance: a shift to **having to make the case why proposals should not be self-governance** (rather than the other way round as at present). There should also be explicit criteria, ideally common across all codes, for deciding when a change should be handled under self-governance or not.
- Code administration: a number of changes **strengthening expectations of code administrators and panels**, including the requirement that all codes panels should have an independent chair, and that every code change proposal form should have a section on consumer impacts.
- Charging methodologies: establish a more developed, informal **pre-modification process**, and a forward workplan for ‘priority’ charging areas.

In addition, industry actors and observers have contributed ideas for reform in their submissions to the consultation processes accompanying the CMA and Ofgem reviews. A summary of our interpretation of their responses is provided in Table 2 below.

**Table 2: Ideas for Code Reform**

|  |  |   |
|--|--|---|
| <b>Changes to codes</b>  | Consolidate (and simplify) codes   | Citizen’s Advice, Elexon, Good Energy, SSE                              |
|  | New code objective on consumers  | Citizen’s Advice, Elexon, Good Energy                                   |
| <b>Changes to code modification and administration processes</b> | Standardise governance arrangements to best practice across all codes (including independent panels, better representation for smaller participants etc) | EdF, Cornwall Energy, RWE npower, Ecotricity, Opus Energy, SSE, Gemserv |
|  | Greater oversight of code administrators   | EdF   |
| <b>Changes to governance architecture</b>                        | Cross-code expert group (resuscitate Cross-Code Forum)   | Elexon, First Utility, Opus Energy                                      |
|  | Single code administrator and/or centralised code management system  | RWE npower, Cornwall Energy, Good Energy, First Utility, Gemserv        |
|  | Design Authority   | EnergyUK, RWE npower, IET, Cornwall Energy, SSE, BG                     |
|  | Independent adjudicator to replace Ofgem   | RWE npower, Cornwall Energy   |

Source: Lockwood 2015<sup>15</sup>

### **3. Key issues raised at the Codes Governance Workshop**

The Energy Policy Group (EPG) hosted a Codes Governance Workshop on 16 October 2015. The agenda and attendees can be found on the [IGov website](#). The workshop was divided into two sessions covering what EPG considered to be the two key issues: Session 1: Discussion of code simplification, consolidation and administration; and Session 2: Discussion of code governance architecture. Below we summarise some of the key areas of discussion, in respect to: 1) Access to Information; 2) Code Simplification & Consolidation; and 3) Code Governance, Administration and Architecture. These issues are interlinked.

A number of key issues were raised over the day. Although there was much agreement over what the issues are, there were essentially two fundamentally differing approaches to how best to solve them (with a range of suggestions between them):

- 'steady as she goes' with incremental change via continuing self-regulation OR
- fundamental change where code administration comes together in one body, and alterations to codes occur not as a result of self-regulation but in line with the needs of the efficient system transformation and operation, albeit with a means for arbitration.

In general, therefore, there was agreement on certain issues, for example that clarity on Code Objectives is needed, but there was no consensus for the next step of how those objectives should be implemented.

In the discussion below we have highlighted under each topic those areas where we feel there was agreement or consensus on a topic, as well as where there was less agreement. It should be highlighted that this is our interpretation of the discussions and therefore does not necessarily reflect any individual's view.

#### **3.1 Improving information and access**

One area of discussion focussed on access to information on codes and how this could be improved, this included the detail of individual codes as well as how different codes link together. This was particularly an issue for new entrants and other actors seeking to understand the codes, but in respect to understanding how different codes link together and impact each other, it also seems to be an issue for those already working within the code environment.

### **3.1.1 Areas of consensus**

Generally it was felt that it would be beneficial, particularly for those working outside of the detailed code environment, if clearer information on each code could be provided. This would include setting out in clear English basic things like: what the objective of the code is, the type of code it is, how it evolved and how it relates to other codes, etc.

Given the complexity of codes (see below), there was agreement that there are some relatively easy opportunities to make codes more accessible to stakeholders. This could include improving the information and support provided through the 'critical friend' process, as well as better information provision. For example, in terms of individual codes it was recognised that different people need different levels of information on the codes, so a possible way forward would be to have layers of information for each code to suit different audiences – linked to better guidance and support. It was suggested that actors sometimes just want to know what they have to do to become compliant with any given code. In addition, actors need to understand how to be compliant with any particular issue, which might cut across different codes. It was highlighted how difficult it is to navigate around the different codes, so better support and guidance on how all the codes fit together would also be of benefit.

One suggestion was that this could be provided by a one-stop-shop as currently there is no single person or organisation that someone can go to get cross code information. For example, they could explain what steps any given supplier, generator or other licensee must take to be compliant with section X, Y and Z of any code/codes, found in Sections 1, 2, and 3, etc. All of this would improve the transparency of codes.

## **3.2 Code simplification/consolidation**

It was recognised that codes are long and complex and in some cases are written in legalese which makes them hard to understand, even for some working within the code environment. This in part links to the points above in terms of how to access information and understand what the detail of a code requires of an actor. Discussions on this led in to a broader consideration of what the opportunities and barriers might be to simplify individual codes and/or consolidate the number of codes. This was an area of discussion where there were many differing views.

### **3.2.1 Areas with consensus**

It was recognised that neither the individual codes nor the introduction of modifications to them give much or any consideration to consumers. This was seen as an oversight that should be addressed, and most agreed that the impact of code modifications should take account of how the change could impact the end consumer (both current and future).

As highlighted above, the codes play an important role in ensuring technical standards are met and play a commercial role in setting out contractual arrangements that underpin the energy industry, thus helping to avoid disputes and providing certainty for actors. However, this certainty had come at a cost in terms of complexity and accessibility of the codes, particularly for smaller actors; but even for larger actors, it was questioned if adding more and more pages to a code does actually bring more certainty. It was also highlighted that it might be possible to simplify codes as a set of principles rather than detailed rules (as is the case in some Scandinavian countries), although some also felt that this approach might lead to disputes and uncertainty within the British context. It was recognised by most that there is probably an optimal area between the large complex codes and smaller principle based codes, although no clear agreement on where the ideal balance lies.

Whilst there was no clear agreement over the need for simplification or any consolidation, there was general agreement that if this did happen a number of important considerations should be taken into account. This seemed to come down to three main areas:

- ensuring that any changes did not create instability in the market
- rights and obligations should not be disregarded, as this would lead to legal challenges
- any costs of making changes are considered alongside the benefits that any change might bring.

Given these sorts of issues, it was recognised that if any changes occurred there would need to be real clarity over what is being changed and why it needs to change i.e. what problem is the change addressing, what is going to happen, by when, by whom and what can actors expect. In addition, people felt that how the change is communicated would be important. An open, transparent process, which is consulted upon with industry, was felt to be a better way to reduce the potential risks of lengthy litigation. Ultimately any changes to code texts would need to be clear, easy to understand, and easy to apply.

### **3.2.2 Areas without consensus**

In respect to simplification there was no overall consensus. There were quite a few ideas put forward: would it be possible to scrap the 1000 pages of codes for new signatories and a 20 page note replace it? Should there be a new, short frontispiece for codes, and the current codes remain? If any simplification is introduced could it include setting out key principles, based on things like consistency, simplification, accessibility of information?

Some felt that it would be important to differentiate between codes covering commercial to commercial (or B2B) interactions, and those governing commercial to retail (or B2C) as different

kinds of rules are needed to regulate these different kinds of corporate relations. Equally, some felt if changes do occur, there could be value in looking at what the main drivers on the markets are and make any amendments accordingly, e.g. in wholesale markets the EU has become a significant driver.

Some felt that there was need for clearer objectives in respect to individual codes, although others felt that some codes have served, and continue to serve, the industry well. It was recognised that much of the details of codes is about contracting issues between consenting parties that don't impact on end-users, the details of these are therefore not relevant to many beyond the consenting parties. As well as the codes, there are also subsidiary documents, clauses, legal text, etc, which again is not relevant to business operation. This links back to the issues around access to information and some felt that codes could be made clearer (not necessarily simplified) by layering the information within them. This restructuring of the information could happen vertically within codes, although some felt it was also needed across codes.

In respect to modifications, there was some suggestion that there should be a new template used for their introduction and that mods should include overt recognition of: consumers, sustainability, innovation, new entrants, etc. Others argued that before this could be done new guidelines are needed, e.g. that define consumer interests given that, as currently written, codes just assume that consumer interests are more or less equal to competition and extend no further.

Another issue that was highlighted was that currently the objectives of individual codes do not match the objectives of Ofgem, which for some did not make sense. Others were not sure if this mattered or whether it should be changed

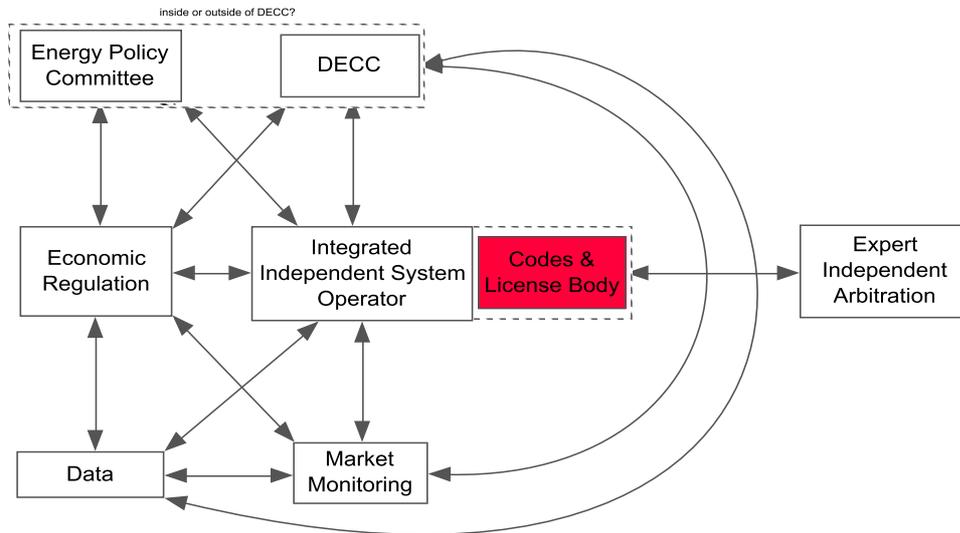
In terms of code consolidation there was no agreement on whether the many codes currently in place should be consolidated into a few codes, and whether the benefit of doing this would outweigh the costs. Some also felt that consolidation might happen anyway as a result of ongoing changes to markets.

### **3.3 Code governance, administration and architecture**

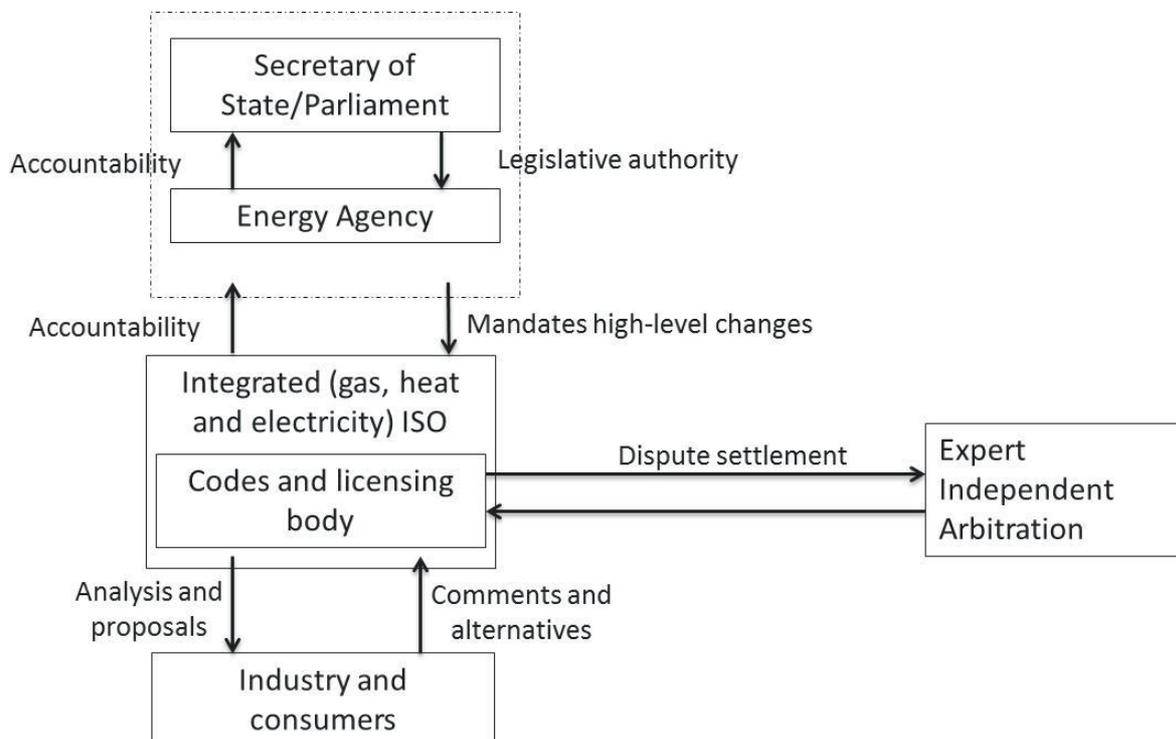
The final section of this discussion paper sets out the debates that were held broadly in relation to code governance. Much of the discussion in these areas ran into each other and there are therefore many overlaps within the summary below. In part, some of the discussions were

based on two diagrams that IGov presented at the workshop, reproduced below, which set out our own thoughts about how governance might change. Figure 1 takes a high level view of codes within the wider governance landscape, whilst Figure 2 provides a more detailed look at a model for code governance. We are continuing to work on these figures and they therefore are likely to be amended in due course.

**Figure 1: Codes in the wider governance landscape**



**Figure 2: A possible model for code governance**



### 3.3.1 Areas with consensus

#### a) In terms of high level governance:

- There seemed to be two high level issues running through some of the discussions, in respect to: a) Who sets the agenda (Ofgem, DECC, or another body); and b) who is then responsible for ensuring the delivery of that agenda. This seemed to particularly be an issue when an initiative cut across different codes and highlighted the need for strategic decision-making in the code environment (which some felt is currently lacking).
- The need for coordination and being able to 'see' across codes was recognised by many as a desirable and important change.
- A key issue for all actors appeared to be constraints around their time and staff resource i.e. Ofgem, DECC, the big suppliers and new entrants. This could impact changes to codes and code governance in the long term.

#### b) In terms of code governance:

- That it is essential that the hierarchy of layers of authority and function in code governance (who takes decisions – who executes – what each layer can and should do) should be clear.
- Panels, when passing or rejecting a modification, should be setting out detailed pros and cons. At the moment, the explanation is often very sparse.
- Modifications often reflect major policy issues, and their outcomes effectively become policy. It was agreed that fundamental policy decisions should not be debated within a Panel but should come directed from a democratically legitimate policy process. An example of this was modifications about 'peaky' cash out prices. Some support it and say that it will empower customers; others consider that it will make renewable development more risky.
- There is a very limited capacity within GB of people who really know the codes, and still fewer people understand all the codes, and those who do are working either in the Code Administrators and/or Panels or within industry. In particular informed actors can be found within big companies; or in consultancies like Cornwall Energy who specialise in advising smaller entrants; or sometimes in a smaller company that have someone responsible for the codes of that company. Whatever changes occur, GB cannot afford to lose its already small capacity, knowledge and skills in this complex area.
- While it was not agreed what code governance changes are required (as discussed below), it was agreed that whether changes are reasonably minimal, or greater, the Code Panels and Administrators need to understand their impacts on different parties across codes as well on individual codes; which implies a need for more coordination. In addition, the roles of other institutions in relation to governance change need to be

understood. For example, what should the role of Ofgem be within future code governance change? All of these relationships should be set out in Strategic and Policy Statements.

**c) In respect to code administrators:**

- There was some agreement about the need for greater coordination between code administrators and/or for one body to be able to think across codes. The Code Administrators have already initiated improved coordination, but it was accepted that there could be more. It should also be noted that Code Administrators wanted to retain their independence and did not want there to be one single Code Body.
- Code administrators play a neutral role are basically passive, but there was a general view that it would be useful if they were more proactive. However, they are not set up to be active, so if a new role for them is wanted then their remits and objectives would have to be altered.
- There was a general feeling that thinking of them as code managers, rather than administrators, would be a good first step in moving them to a more pro-active role.

### **3.3.2 Areas without consensus**

**a) In terms of high level governance:**

- IGov put forward in the meeting our initial thinking around high level governance – i.e. Figures 1 and 2 above, and we have a forthcoming working paper that will further examine these. Within the IGov proposal there is an Integrated Independent System Operator (IISO) which is given responsibility from DECC to enable the technical transformation of the energy system so that it reduces emissions by 80% by 2050, as specified in the Climate Change Act 2008, and to maintain security whilst doing that. The IISO would, for example, decide what technical changes were required to networks and the energy system transitions. The Code Administrator Body would then work out the necessary modifications, and there would be a process for discussion amongst industry. There would also be an Expert Independent Arbitration body to which those who disagreed on the Code Modifications could appeal. The Economic Regulator would regulate the networks based on IISO decisions. This gets rid of Code Panels and self-regulation and reflects a view that codes are technical requirements. This is only one suggestion and others were presented at the Workshop, which we will seek to add to the IGov website, with the authors permission. There were a wide range of discussions on the differing ideas put forward and no obvious consensus over the best way forward.

- It was also raised that there should be a more direct link between codes and government energy policy and objectives. At the moment Code Administrators do not need to link the codes, or code changes, to formal public policy objectives of climate change mitigation, improving GB energy poverty and energy security. For example, the Committee on Climate Change sets out various technology paths to meet the emission reductions targets but there is currently no need for the codes to be compliant with that, nor indeed to consider current or future consumers.

**b) In terms of the code governance:**

- A key area of debate was around the issue of self-governance i.e. industry initiatives code changes and whether this should change.
- This area is part of wider questions about institutional reform in energy governance. On the whole, those who support a Code Administrator, which is able to take code decisions (thereby speeding up the process) recognise that wider institutional reform is needed.
- There was no consensus on who would have responsibility to make the modification changes. This was in part because there was also no consensus on whether there should be a single Code Administrator or whether the Code Administrators continue as they are; and if there is one Code Administrator, who would make decisions on what modifications have to happen. Would it continue to be via separate codes and panels within the Code Administrator; or could the Administrators initiative mods for panels to consider; or would there be higher strategic guidance?
- It was highlighted that Code Panels have two roles but that these maybe should be separated out. Partly they are cooperative because they sit together to ensure the Code Administrator is operating efficiently, the code is operating efficiently and that are budgets being properly managed, etc. However, they also look at the modifications to legal text within the code and this has commercial implications for them. It was suggested by some that having more proactive Code Administrators (see below) that put forward recommendations and made decisions could remove the concern about panels being populated by groups that have material interests in the outcome of a modification.
- Some also felt that panels should be required to be more pro-active and strategic, working across codes. And that working groups should be more enabling and advisory in nature.
- There was also discussion on the need to try and align code processes. Some felt that, in terms of the process of change, there should be a standard format for modifications or changing governance for a code. However, others highlighted that the codes have individual governance structures in place, so that decisions within panels, are often based on the individual principles and objectives of that code and of the parties that are within it. This makes it hard to take standard approaches to change across codes.

### **c) In respect to code administrators:**

- They could have different roles: i) they can be reasonably passive administrators who execute decisions taken elsewhere; or ii) they can be more active and strategic, potentially shaping and inputting ideas to further the objectives of the code, ensuring they are being met. Some felt this should go further and that the Administrator should be able to raise modifications. This would see them acting as independent bodies, raising changes for industry actors to consider.
- It is possible to think of different levels of Code Administrator service: e.g. 'bronze', 'silver' and 'gold'. 'Bronze' level would be about making the process work and relying on industry to provide the intellect, as compared to a 'gold' level which could be a highly resourced and proactive service which goes beyond current practice i.e. managing and driving the code. Some felt that the 'gold service' is what we should be aiming for.
- If Code Administrators did take a more strategic role, some felt it would be important to put in place mechanisms to ensure they could be held to account, such as time limited contracts that would require them to tender for the work every few years.
- There was also some discussion about whether code administrators should be 'co-located' in the same building:
  - This could potentially ease coordination, increase accessibility of codes/licenses for new people and increase availability of expertise. Such a model could have a strong secretariat that does code administration and practice, and a strong education team that provides advice and expertise to industry actors.
  - Co-location might also help with any efforts to consolidate codes.
  - Some suggested that it might also help to reduce costs, as some centralised functions like HR, communications, etc could be shared.
  - It was however questioned whether having one overall code manager or governance body could understand and manage all the rules.

## **4. Conclusions and recommendations**

Energy industry codes play a crucial role in shaping the energy system. Major changes in codes will be needed as the industry, especially the electricity industry, undergoes transformation to a low-carbon decentralised system, with new business models, new flows of data and new markets. Code governance, and in particular the process by which changes are made to codes, needs to be sufficiently flexible to avoid a situation where codes are a barrier to meeting policy objectives and to new market entrants, as has been the case on several occasions in the past.

The last seven years have seen a number of reforms to who governs industry codes, what processes are involved, and what needs to be considered in the change process. Despite these reforms, many of the problems identified in the original 2008 Code Governance Review remain. As of late 2015 two official reviews, by the Competition and Markets Authority and by Ofgem, were still ongoing. However, both of these reviews are limited in scope. The CMA review is limited by the terms of reference of the wider energy market investigation, with a relatively narrow focus on competition and harm to current consumers. The Ofgem 2015 review explicitly considers only incremental changes to the framework set up by the earlier 2008 Code Governance Review.

Crucially, both of these official reviews do not consider potential changes to code governance within the context of reform to the governance of the wider energy system. For example, they do not address the question of how code governance should relate to a widely called-for body that would steer the transition to a low-carbon decentralised energy system.<sup>16</sup> They do not raise the question of whether it is appropriate for Ofgem to be the body overseeing code governance in terms, for example, of whether Ofgem has the resources, expertise and democratic legitimacy to undertake this task efficiently and effectively. They do not investigate whether the deeper function that codes fulfil, i.e. the governance of contractual relationships in the energy sector, is better served through the current approach of the detailed rulebooks that codes represent, or through the approach seen in some other countries in which a brief set of principles sits on top of a series of bilateral contracts. The current reviews also do not question the fundamental principle of industry self-governance.<sup>17</sup>

Thus while the CMA and Ofgem reviews are welcome, we argue that they do not necessarily address the much broader range of views currently on offer, and as evidenced by the discussion in this workshop, including fundamental questions around self-regulation. Therefore we argue that **the Government should instigate a more thorough review of code governance, including potential changes to the architecture within the context of wider changes to energy sector governance.** An increasing number of proposals for such wider changes are being made. We have already published two iterations of our Draft Proposal, including our earlier [Public Value Energy Governance](#) working paper, and we will be publishing a further detailed working paper on code governance in the coming weeks. Our thinking on code governance reform is informed by our wider IGov work on the governance of the energy system as a whole, and we will also be publishing further papers on this during 2016.

## References

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<sup>1</sup> This includes six codes for renewable energy and the code for independent gas transporters (iGT UNC).

<sup>2</sup> Ofgem and BERR *Transmission Access Review: A call for evidence* (2007)

[https://www.ofgem.gov.uk/sites/default/files/docs/2007/08/070816\\_ex\\_tar-call-for-evidence\\_final\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2007/08/070816_ex_tar-call-for-evidence_final_0.pdf)

<sup>3</sup> Julia Davenport quoted in Good Energy Press release on the CMA inquiry, 7 July 2015

(<http://www.goodenergy.co.uk/press/releases/2015/07/01/ceo-statement-on-cma-investigation-into-the-energy-market-findings-due-7-july>)

<sup>4</sup> For example, DCUSA was established in 2006, replacing a number of bilateral contracts – see

<http://www.dcusa.co.uk/Public/DCUSADocuments.aspx?s=c>.

<sup>5</sup> The Security and Quality of Supply Standard (SQSS) was created in 1997, but originates in Central Electricity Generating Board planning and operating standards developed in the 1960s and 1970s. The equivalent for electricity distribution, Engineering Recommendation P2, also shares the same origins (see Kay 2012:

<http://www.dcode.org.uk/assets/images/P2%20Security%20of%20Supplies%20Open%20Letter.pdf>).

<sup>6</sup> <https://www.ofgem.gov.uk/licences-codes-and-standards/codes/industry-codes-work/code-governance-review>

<sup>7</sup> GEMA (2008) *Minutes of the meeting of the Gas and Electricity Markets Authority, Thursday 19<sup>th</sup> June*, pp 3-4,

<https://www.ofgem.gov.uk/ofgem-publications/38072/19-june-2008.pdf>

<sup>8</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2015/08/proposed\\_cacop\\_v.4.0\\_clean\\_version\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/08/proposed_cacop_v.4.0_clean_version_0.pdf)

<sup>9</sup> <https://www.ofgem.gov.uk/ofgem-publications/61741/ghgguidancejuly2010updatefinal080710.pdf>

<sup>10</sup> <https://www.gov.uk/cma-cases/energy-market-investigation>

<sup>11</sup> <https://www.ofgem.gov.uk/publications-and-updates/open-letter-further-review-industry-code-governance>

<sup>12</sup> Brattle Group/Simmons and Simmons (2008) *Critique of the industry codes governance arrangements – A report for Ofgem*, <https://www.ofgem.gov.uk/ofgem-publications/61470/20080612-codes-governance-review-final-draft.pdf>

<sup>13</sup> Competition and Markets Authority *Energy Market Investigation: Provisional findings report* (2015: 471),

[https://assets.digital.cabinet-office.gov.uk/media/559fc933ed915d1592000050/EMI\\_provisional\\_findings\\_report.pdf](https://assets.digital.cabinet-office.gov.uk/media/559fc933ed915d1592000050/EMI_provisional_findings_report.pdf)

<sup>14</sup> Ofgem *Code Governance (Phase 3): Initial Proposals* (2015),

[https://www.ofgem.gov.uk/sites/default/files/docs/2015/10/cgr3\\_initial\\_proposals\\_final\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/10/cgr3_initial_proposals_final_0.pdf)

<sup>15</sup> Lockwood, M. (2015) Introduction to Codes Governance Workshop, 16 October 2015

<http://projects.exeter.ac.uk/igov/wp-content/uploads/2015/11/ML-Codes-governance-workshop-intro-Oct-2015.pdf>

<sup>16</sup> Different versions of such a body have been termed: an energy policy committee, an energy agency, a design authority and a system architect. What they all share in common, however, is the notion of a body that coordinates the different parts of the energy system as it goes through transition, a task that markets alone cannot manage and which at present no single body has the remit to take on.

<sup>17</sup> Although the proposal to allow Ofgem to raise modifications itself under the SCR route moves away from this principle

\* **Amendments:** the following changes were made to this paper in December 2015:

- Context: removal of phrase ‘10 main industry codes’ from body text and title of Table 1 – we recognise that codes and markets are all interconnected.
- Table 1: amendment to entry on MRA and inclusion of SPAA
- Section 3.3.1 section c): changed description of code administrators, from playing passive role, to neutral role. This more accurately reflects the role they play, both within the rules that govern them under the individual codes and taking account of the changes introduced under CACoP.