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13th February 2014

URN 13D/326 – EMR: Consultation on Industry code and licence modifications

We welcome the opportunity to respond to the consultation on industry code and licence modifications under the Electricity Market reform (EMR). The consultation document invites ‘further comments and evidence’ in addition to direct response to the consultation questions, and our response is of this nature.

According to the consultation document, a major objective of the EMR is to ‘enable the UK to meet its ambitious climate and renewable targets to build a cleaner energy future for Britain and the world’ (p. 6). A key mechanism of the EMR is the contract for difference for low-carbon generation, along with ‘measures to encourage and support new entrants into the electricity market’ (p. 7).

Regardless of the detailed changes to codes and licences proposed in the consultation document, we believe that progress towards the objectives of greater sustainability and openness to new entrants in the EMR are likely to be undermined by the deeper issue of how codes are governed and licence objectives defined. We believe there are four main issues:

- The codes and licences were originally drafted at privatisation over 20 years ago when policy objectives were different. **Both sets of documents should be significantly ‘reset’ to reflect the major changes in policy since then.**
- As both submissions to Ofgem’s 2008/09 Code Governance Review¹ and the independent assessment of code governance by the Brattle Group and Simmons and Simmons² noted, code objectives (which focus on ensuring effective competition) have not been changed to reflect amendments to Ofgem’s remit in relation to sustainability. The independent assessment noted that: “Differences between the code objectives and Ofgem’s statutory duties means that the assessment of proposals takes place against one set of criteria while the decisions are made against a different set of criteria.”³ The modification rules are based on licence conditions, which state that Ofgem’s decision as to accept or reject a modification will depend on whether, in Ofgem’s view, the modification better achieves the relevant

¹ e.g. Davenport, J. (2008) ‘Codes governance and the sustainability challenge’
<https://www.ofgem.gov.uk/ofgem-publications/61474/juliet-davenport.pdf>

² 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>

³ *ibid.*, p. 4)

objectives. **Code objectives should be changed to make sustainability an objective alongside effective competition.**

- Code Panels underrepresent consumers and smaller companies representatives. For example, as of February 2014, of the 11 members of the CUSC Panel other than the chair, secretary and the Ofgem representative, 7 represented or were employed by either National Grid or one of the 'Big Six' large incumbent energy firms, while a further member was employed by the industry association in which it is generally recognised that the large incumbents lay a dominant role. There is only one consumer representative. The SQSS Panel has a majority membership of representatives of transmission operators. While the BSC Panel currently has a larger number of independents, it also has only one consumer representative and no representative of smaller companies. The fact that Code Panels were not necessarily functioning in such a way as to allow smaller industry participants to participate fairly was recognised in the fact that it has been considered necessary to introduce a Code Administration Code of Practice. However, such a measure is a poor substitute for better representation of a greater range of interests. **Code Panel representation should be less skewed towards representatives of large incumbent companies, and have greater representation of consumers, the public interest and smaller companies so that there is no 'automatic' ability for the status quo or incumbent interests to prevail.**
- The Code Governance Review did lead to the introduction of the Significant Code Review process. However, this has proven slow and cumbersome, taking over two years to get the first two reviews to a decision by Ofgem, with actual modifications as yet to take place. While we recognise the importance of codes and code governance for commercial decision making, we believe that the process by which the regulator, acting in line with Government policy, can make amendments to industry codes is too slow. **The process of Significant Code Review should be revisited to seek ways of expediting such Reviews.**

In conclusion, we do not consider the current governance arrangements for electricity Codes fit for purpose, with consequent effects on Licences. We believe a new approach to Code governance is needed, and that such an approach would best be developed through an independent review by a group that has a strong representation of smaller energy companies, consumer interests and the public interest, including environmental concerns.

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