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Paper Reference:	SECP_127_2304_05
Action:	For Decision
<u>Acronyms and Defined Terms SEC Glossary</u>	

Consultation – Code Licensing & Code Manager Selection

1. Purpose

We have drafted a response to the joint DESNZ and Ofgem consultation on Code Licensing and Code Manager Selection, for the Panel to review. The draft response is contained in the Annex to this paper.

The Panel is requested to review and approve the draft response. A copy of the consultation document can be found [here](#).

The consultation closes 05 May 2024.

2. Recommendations

The Panel is requested to:

- **NOTE** the contents of this paper; and
- **AGREE** the draft Panel response be submitted to Ofgem subject to any final comments to be received by 30 April 2024, and final agreement with the Panel Chair.

Tim Newton

SECAS Team

16 April 2024

Attachments

Annex: Draft SEC Panel Response – Code Licensing & Code Manager Selection

Annex – Draft Panel Response – Code licensing & Code Manager Selection

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XX May 2024

Ofgem / DESNZ Consultation – Code Licensing and Code Manager Selection

Dear Sir / Madam,

The Smart Energy Code (SEC) Panel is pleased to respond to the recent consultation on the proposals for Code Licensing and Code Manager Selection. We have set out our response to the consultation questions below. We would be happy to engage further, to assist with any clarifications.

We agree the proposals in the consultation and the drafting of the Licence Conditions broadly deliver the intent. We provide additional observations and comments for consideration.

An area that is unclear to us, is that of Code Manager compliance with the Licence and consequences of not doing so. Licensed organisations are traditionally open to fines for inferior performance or noncompliance with their Licence Conditions. In the case of a Code Manager funded by industry Parties, if the Authority were to impose a fine, the Code Manager funds would be from the very Parties to whom it has been poorly performing. It is unclear at this moment, what alternative consequences to a fine (other than a licence revocation) there may be. This level of detail should be included in the Licence so that it is transparent to all Parties what the potential consequences for poor Code Manager performance may be.

We agree that budgets should be set by code managers in consultation with stakeholders. However, there needs to be sequential consultation of the new Ofgem Strategic Direction Statement (SDS) and budget to help ensure funding to deliver SDS requirements in the next Regulatory Year.

Regarding the period for the Code Manager Licence, we consider that whilst an enduring Licence might provide greater certainty, it might not necessarily translate into focussed delivery of services over time. We propose that a time limited Licence would be more effective and would suggest an 8-10-year term, with an option to extend up to a further 3 years. This should ensure that services can be delivered appropriately, after an initial appointment, and there would then be a good period of service delivery to assess the performance of the incumbent prior to going to market again.

Finally, we would like to note that there is a need for completing the implementation of these reforms and the appointment of Code Managers as soon as possible to mitigate risks of uncertainty that the changes bring. To mitigate this risk, we urge Ofgem and DESNZ to not delay with decision making required so that industry can move forward with certainty on its future governance arrangements as quickly as possible.

If you would like to discuss any of the issues in this response further, please do not hesitate to contact me at SECAS@gemserv.com.

Yours faithfully,

Angela Love
SEC Panel Chair

DRAFT

Joint DESNZ Ofgem Consultation – Code Licensing Code Manager Selection

1. Code Manager Licence

Q1.1: To what extent do you agree with the proposed high-level content contained in the licence skeleton? For example, are any of the proposed contents unnecessary or are there any additional areas related to the code manager's role that should be subject to licence rules?

We do not have any additional requirements to add currently. We agree with the high-level content.

2. Not-for-profit Requirement

Q2.1: To what extent do you agree with our proposal that the code manager must fulfil its core licensed business on a not-for-profit basis?

We understand the rationale for this, although this may have an unintended consequence of limiting the number of potential candidate organisations for the Code Manager role.

Licensed organisations are traditionally open to fines for any inferior performance against their licence requirements. In the case of a Code Manager funded by industry Parties, if the Authority were to impose a fine, the Code Manager would presumably pay from funds the Code Manager has obtained from the Parties to whom it has been poorly performing. It is unclear at this moment, what alternatives to a fine (other than a licence revocation) there may be. This level of detail should be included in the Licence so that it is transparent to all Parties what the potential consequences for poor Code Manager performance may be.

Q2.2: To what extent do you agree that the draft licence conditions presented in Annex A ('Annual Budget of the Licensee' and 'Restriction on profit') capture the policy intent set out in this proposal? Do you have any other views or comments relating to the licence drafting?

We agree the proposed conditions sets out the intent as discussed in the consultation document.

3. Setting Code Manager Budgets

Q3.1: To what extent do you agree with our preferred option 1 for setting budgets (budgets set by code manager)? Are there additional checks and balances we should consider and why?

We agree that budgets should be set by code managers in consultation with stakeholders. We do not currently see a need for any third-party assurance or further checks and balances beyond those proposed.

Their needs to be recognition of the potential impact of the Strategic Direction Statement (SDS) consultation alongside the Code Manager draft budget consultation process. The two need to complement each other to ensure the agreed budget has suitable funds to deliver the requirements of the SDS. We suggest the SDS is consulted first to inform the budget for the following year.

Q3.2: To what extent do you agree with our approach to Ofgem oversight of code manager budgets? We welcome views on whether it is feasible and desirable to enable Ofgem to require third-party assurance on budgets.

It is right that Ofgem has oversight of the Code Manager budgets and that Parties may appeal a proposed budget to the Authority for determination. We understand the Stakeholder Advisory Forum may have a role to play in the review and setting of budgets. As part of this oversight, we would expect Code Managers to provide access to audit reports.

A suitable mechanism will need agreeing between relevant Code Parties, the Code Manager and Ofgem, finding a balance between the potential commercial sensitivity of the information and the need of Parties.

Q3.3: To what extent do you agree that the draft code manager licence condition presented in Annex A ('Annual Budget of the Licensee') captures the policy intent set out in this chapter? Do you have any other views or comments relating to the draft licence?

Whilst prescriptive, the process and drafting proposed is clear and we believe reflects the intent set out in the consultation.

4. Code Manager Funding and Cost Recovery

Q4.1: To what extent do you agree with our proposal that Ofgem should decide on a code-by-code basis whether to maintain existing cost recovery mechanisms or to introduce new arrangements?

We agree that funding and cost recovery on a code-by-code basis is correct.

Codes have different purposes, objectives, and drivers of costs. A code-by-code basis is likely more effective and cost efficient to monitor and manage in the longer term.

Q4.2: To what extent do you agree that the draft licence conditions presented in Annex A ('Code Manager Cost Recovery Methodology' and 'Code Manager Cost Recovery Statement') capture the policy intent set out in this chapter? Do you have any other views or comments relating to the draft licence condition?

We agree these reflect the policy intent from the consultation.

5. Code Manager Incentivisation

Q5.1: To what extent do you agree with our proposal that the code manager licence will not include provision for financial performance incentives?

We understand the rationale for not including financial performance incentives.

It should be noted however, that with no formal measure and incentive for financial performance, there is potential that the Code Manager is not sufficiently motivated to deliver the services to the standards envisaged and deliver the benefits the Code Reform programme expects.

We suggest there needs to be both quantitative as well as qualitative review and measurement of the services provided, to fill the gap of no financial incentive. This requires a need to include where possible quantitative measures. The obvious candidates might be the volume of Modifications or Code Changes outstanding more than "X" period, but this may be influenced by several factors the Code Manager may argue is beyond their control. Other measures might include adherence to budget spend, management of 3rd party service providers to the Code Manager or delivery of prioritised change per the SDS, might be considered.

Q5.2: To what extent do you agree with our proposal that the licence would allow code managers to modify KPIs in consultation with stakeholders, and report against these?

There needs to be flexibility in the arrangements as services change over time. We therefore agree that there needs to be an ability to modify the measures as the services change.

Q5.3: To what extent do you agree that the draft code manager licence condition presented in Annex A ('Code Manager Performance Incentives') captures the policy intent set out in this chapter? Do you have any other views or comments relating to the draft licence condition?

We agree the drafting as proposed delivers the intent. Clause 4.8 refers to "a thorough evaluation of the Licensee performance." This text appears rather subjective. It is unclear what is meant by "thorough evaluation" in this context.

Further, the requirement for an annual report, whilst useful may mean that it is two years or more before any trends may be reviewed. A more regular set of reporting might be appropriate, however, consideration against the cost burden on the Code Manager and Stakeholders to action and review, versus benefits would require analysis.

6. Conflict of Interest and Independence

Q6.1: To what extent do you agree that the proposed package of conditions should be included in the code Manager licence, to manage potential conflicts of interest?

We understand the rationale for the inclusion and agree with the proposed content.

Q6.2: To what extent do you think it is necessary to include additional prescription relating to:

- **Restrictions on directors' affiliations; and/or**
- **Business separation requirements?**

We agree that these seem appropriate to ensure independence.

Q6.3: To what extent do you agree with our proposals that the licence conditions listed below should include the possibility of exemptions? Are there any other proposed conditions that you think should include the possibility of exemptions?

- **Restrictions on activity and investments**
- **Restriction on the licensee becoming a related undertaking**
- **Restrictions on directors' affiliations**

We agree with the proposals. We do not consider there are additional exemptions.

Q6.4: To what extent do you agree that the draft licence conditions presented in Annex A ('Conflicts of interest') capture the policy intent set out in this chapter? Do you have any other views or comments relating to the draft licence condition?

These seem reasonable and reflect the intent.

7. Financial and Operational Controls

Q7.1: To what extent do you agree with the proposed requirements on financial and operational controls? Do you have any views on the options presented for obtaining assurance on financial stability of the code manager?

We agree these are reasonable but under either option it is not clear if this is an annual or one-off requirement to provide assurance to Ofgem. We assume the former.

Q7.2: To what extent do you agree that the draft licence conditions presented in Annex A ('Financial and operational controls') captures the policy intent set out in this chapter? Do you have any other views or comments relating to the to the draft licence condition?

These seem reasonable. We are pleased to see the operational controls element goes beyond purely financial stability, such that the code manager must ensure it has suitable resources available to fulfil its obligations alongside financial capability. In regard to "rights" and "licenses" we assume these refer to any required Intellectual Property Right(s) needed by the code manager to fulfil its requirements.

8. Code Maintenance and Modification

Q8.1: To what extent do you agree with our proposal to require code managers, in their licence, to have in place and maintain the relevant code?

We agree with the proposed approach.

Q8.2: To what extent do you agree on the initial drafting proposed for the 'Code maintenance and modification' standard licence condition presented in Annex A?

We note that the review of Code Objectives is yet to complete, but overall agree with the proposed drafting.

9. Code Manager Selection

Q9.1: To what extent do you agree with the proposal not to place additional restrictions or eligibility requirements on who can be selected as a code manager in regulations, aside from a mandatory assessment of conflict of interest?

This is a sensible and efficient route to take.

Q9.2: To what extent do you agree with the proposal to consider speed of delivery and value for money when deciding how to select code managers? Do you have any views on our proposed preference for non-competitive selection?

This seems a pragmatic approach. There is a need for the process of the appointment of Code Managers to commence as soon as possible, to mitigate risks of uncertainty that the reforms bring. To mitigate this risk, we urge Ofgem and DESNZ to not delay with decision making so that all impacted parties can move forward as quickly as possible.

Q9.3: To what extent do you agree with the proposed process and criteria for appointing a code manager on a non-competitive basis?

Yes, this seems reasonable.

Q9.4: Do you have any views on whether code manager licences should be granted on an enduring versus time-limited basis?

Whilst an enduring Licence might provide greater certainty, it might not necessarily translate into focussed delivery of services over time.

We propose that a time limited Licence would be more effective and would suggest an 8 -10-year term, with an option to extend up to a further 3 years. This should ensure that services can be delivered appropriately after initial appointment, followed by a suitable period of service delivery to assess performance prior to assessing the market again.