Energy Code Reform Call for Input

ESO

January 2023

ESO

Q1: Do you agree with the design principles proposed to frame our assessment of code consolidation options?

If 'no', please explain why.

Overall, we agree with the design principles outlined within the Call for Input subject to a few clarifications and additions.

We agree that making the codes easier to engage with and understand should improve market participation and is key to ensuring code consolidation works. Currently a market participant may need to engage and understand multiple processes across multiple codes. For new entrants to the industry, this may be seen as a barrier and hamper innovation. There is also currently a lot of duplication across codes (for example D Code includes similar detail from the Grid Code and there are STC requirements detailed in the Grid Code). Additional activities could be undertaken to make it easier for new participants to enter the market by including elements of data best practice and bringing more consistency to the different data requirements of each code.

We agree that making codes agile and adaptable for future market arrangements is crucial for the GB market as it meets the challenges of Net Zero. We are likely to see further changes and innovation across the energy system and ensuring that the codes facilitate and do not block these is incredibly important. Currently the arrangements are not as agile or adaptable as they could be; one example of this is the Grid Code modification GC0141 "Compliance Processes and Modelling Amendments following 9th August Power Disruption". This took 2 ½ years to develop with the workgroup process generating alternative solutions in 8 different areas. This totalled up to 1800 possible complete solutions which all required analysis to find "the optimal" solution.

The above example also shows that the current process adds complexity due to the large number of possible solutions. This magnifies the issue for smaller parties as they may not have the resource (and potentially capability) to understand the detail required for each option. Furthermore, legal text was also required for all 8 different solutions, taking up valuable time and resource to draft, review and understand from all parties. The level at which the legal text is written for the code does not help parties, particularly those with less resources, in understanding their obligations clearly and with ease. This is due to the level of detail that currently sits within the codes. We believe that this could be made simpler and more efficient by inputting overarching principles within the codes and removing complex methodologies. This would be much more efficient and clear for industry.

We agree that the design principles should also facilitate delivery of strategic change and drive new code governance arrangements. Currently there is little information on the new governance arrangements so we do question how this can be scored accurately.

We agree that supporting the on-going operation of central systems is key to ensuring the industry is able to operate efficiently. It will be important for Ofgem to ensure that there is co-ordinated delivery of change across multiple entities and an approach through the new governance arrangements to this will be important to consider.

In addition to the above, we consider that subject matter expertise is crucial for a code manager to successfully carry out its activities and deliver the most value for consumers. This should be thoroughly considered through the Code Manager process and valued above most other metrics if any assessment or tender process is followed. This should also be taken into consideration as part of the code consolidation process.

Lastly, we are surprised that "support delivery of Net Zero" is not within the design principles at all. Given the over-arching goal for Energy Code Reform is to drive progress towards Net Zero, we would expect this to be a key part of the decision making on code consolidation. Missing out this element risks codes being consolidated in such a way that hampers progress or does not facilitate Net Zero.

Q2: What are your views on the high-level options for code consolidation we have described ('no consolidation', 'vertical' & 'horizontal')?

We welcome input on the possible benefits/disbenefits of each option.

We agree that consolidating the codes will ensure that Code Managers can deliver efficiencies such as progressing key strategic changes that are vital to net zero, delivering at a faster pace, and simplifying processes. We do think that it is important to consider how to consolidate and which codes could be consolidated in order to meet these efficiencies. In addition, it will be important to consider which organisations could deliver the Code Manager role when consolidating the codes.

We agree that not consolidating the codes misses opportunities such as standardising requirements, making the codes simpler to understand and interact with, and setting the codes up to be fit-for-purpose for the future. In addition, not consolidating, does not help meet the design principles. Opportunities to make code processes more efficient could be explored, such as standardising the governance process and credit requirements. This could be done prior to code consolidation in order to make best use of time. Please refer to our RIIO2 business plan[1] where we have explained the benefits of consolidating a Whole System Technical Code. As part of this work we have focussed on workstreams that, although not consolidating the code as yet, are relevant to it as an end goal, such as digitalisation, simplification, and rationalisation.

We agree that vertical consolidation, whereby gas and electricity codes are kept separate, is the most sensible approach and that there is a spectrum of consolidation options within this. Option 1a (networks consolidation of a Gas, Tx and Dx approach) could present challenges from a content perspective as there are very different drivers for commercial and technical codes. Option 1b (technical consolidation of all electricity technical codes) will be easier to achieve as while broader stakeholder representation will be required, the content is already relatively aligned with significant areas of overlap. In addition many of the stakeholders are already involved in multiple forums across these arrangements. Note that some work has already been done in this area from the Whole System Technical Code project, please refer to our RIIO2 Business Plan for further detail as described above.

We also believe that the charging methodologies should be removed from the CUSC and situated within a charging methodology statement that the ESO are obligated to publish and update annually. This supports the design principle of making the codes easier to understand as the complex methodologies, in our opinion, do not function well within the code processes. It would be more efficient and make it easier for market participants to understand, if the principles of the charging methodologies were within the codes, and the detailed methodologies moved to a charging statement that would be held separately.

We also think that code consolidation may need to be seen as an iterative process; consolidation of some codes now does not rule out further consolidation in the future. Energy Code Reform is trying to set the code landscape up to deliver Net Zero and as technology develops it will be almost impossible to pre-empt what the landscape will look like in 5 year's time. Therefore, in order to ensure that Energy Code Reform delivers, it will need to be reviewed in an iterative manner, balancing stability for the industry, and driving innovation to get to Net Zero.

We do not think that horizontal consolidation will deliver the benefits that are envisaged through Energy Code Reform. Whilst it may work for the Retail Codes (REC,SEC, DCC), it would be incredibly inefficient for wholesale markets as gas and electricity are very different commodities with very different customer journeys. We have also thought about consolidating codes from a whole energy system perspective (i.e. gas and electricity) and have come to the early conclusion that whole system thinking currently sits best outside of the codes. Trying to consolidate from a whole system perspective feels too premature currently with unclear benefits for the level of complexity involved.

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[1] https://www.nationalgrideso.com/document/266156/download

Q3: Do you agree with our initial preference to explore vertical code consolidation options and, if so, do you have any observations on the potential models set out in Cornwall Insight's April 2022 report?
We welcome specific views on the following:
•Whether the UNC and IGTUNC should be consolidated;
• If/how to consolidate the electricity codes;
• Whether the REC and SEC should remain separate; and/or
• Whether the consolidation of any codes should be prioritised, and if so, why."
In order to make a final decision on code consolidation, more detail is required on what and how Code Managers will be expected to do, as well as the method of consolidation.

We understand why Ofgem have considered vertical consolidation noting that there is currently a huge amount of change happening within the electricity industry. It's important to consider this context, and ensure the change is manageable. This could be seen as a stepping stone to further consolidation in the future.

a)   ESO believe that consolidating the UNC and IGTUNC seems sensible as it makes sense to have them in the same place, similar to DCUSA.

b)   ESO believe that there is merit in consolidating the Technical Codes (Grid Code, Distribution Code and SQSS with further thought required on the STC) as the subject matter is relatively aligned with considerable overlap, the stakeholders are also often common, and ensuring there is standardised process across them which will also aid in whole system thinking. We note that implementing complex changes, such as the potential updates from the Connections Reform programme, will be more agile and effective once codes are consolidated and simplified. It will also be more efficient with a Code Manager in place as the governance process will be streamlined and changes can be strategically managed.

There are then a number of aspects to consider when consolidating:

You could consolidate codes by empowering the Code Manager to simplify and rationalise the documents. We consider this should be approached in two steps once a Code Manager is appointed:

- Step 1 would create a single code with all the documents aligned as per their original drafting enabling the same requirements to exist on parties as they do today. This could be in a digital or "physical" manner.
- Step 2 to rationalise and simplify by standardising processes and removing duplicated parts and contradictions.

We believe that Code Managers should have consolidation as a strategic objective with the correct powers to deliver it quickly and efficiently. This would be beneficial in two ways. Firstly it would allow the Code Manager to take full responsibility for their consolidated code, rationalising it in a way that enables them to best fulfil their function and secondly will produce results in a faster timeframe than if consolidation was attempted prior to Code Manager appointments and reform of the governance processes. This also reduces the risk of any contradictory outcomes.

c) ESO currently do not have interaction with the REC and SEC.

d) There has already been consideration and industry engagement on Technical Code consolidation as part of the ESO's RIIO2 deliverable A6.5. We believe this is further ahead than other code areas in terms of the required work and prioritisation. It may be appropriate to consider a pilot of consolidation by bringing some of the Technical codes together. Further time is needed to develop the thinking and details of this approach but

this could be a way to formalise governance arrangements and enable any initial concerns from consolidation to be learnt from before attempting other more complex industry codes.

Q4: Do you agree with our preferred implementation approach (Option 2)?

• If so, do you have any additional observations on what we should consider when further developing this approach, including which code provisions should be considered within the scope of governance arrangements?

• If not, please provide details.

We agree that Option 2 seems like a sensible approach, and that a Significant Code Review process would take too long to implement and would be subject to some of the issues stated. It makes sense to have a common contractual framework and use the transitional powers from the bill to underpin the change.

Regarding governance arrangements, it is important to allow the Code Managers to be empowered, with a clear strategy and responsibility to carry out their obligations.

Q5: Are any of the contents we have identified for the licence conditions unnecessary, or, would be more effectively covered outside of the licence (e.g. in the codes)?

Ownership, code objectives and compliance requirements should sit within the license. In addition, areas that constitute direct Ofgem requirements or duties such as what the criteria are for Ofgem decisions, and of Ofgem's role in enforcing compliance or resolving disputes, also need to be clear in the licences. The requirements on the Code Managers to engage with stakeholders and particularly to what extent stakeholder feedback needs to be acknowledged or followed should also be included. Detailed requirements and further obligations should then be in the codes.

It is our belief that most of the detailed content should be covered within the code itself, and not within the licence, as the codes are comparatively easier to change and achieve a better engaged solution through the participation of stakeholders.

Further detail of the roles and responsibilities of Code Managers would be required for a fuller response.

Q6: Are there any additional areas that should be subject to licence rules?

The license should include practical elements of transition to Code Manager and run-off arrangements that may be required.

It would also be useful to undertake a review against other licenses that organisations will hold and ensure there is strategic alignment.

We would also suggest that "ensuring consumer value" and "enabling net zero" is included in the relevant objective in the license to ensure that the Code Managers are properly aligned to these strategic goals.

In order to fully answer this question, more detail is needed on the expected roles and responsibilities of a Code Manager.

Q7: Do you agree with our indicative prioritisation for policy development, and do you identify any specific dependencies that you think we should factor into our policy considerations?

The ESO agrees that the priorities seem broadly sensible with one caveat; tendering (or indeed appointment) of the Code Managers. We believe that this should be a priority, however we would also note that before appointment of Code Managers it will be essential to determine a direction for code consolidation. We would assume that consolidation is likely to be a task that falls to Code Managers to progress. If this is not taken into account as part of the appointment process, complex and short-lived transitional arrangements will be necessary. It would further be logical for a single party to become the Code Manager for a group of codes that were to be consolidated.

In terms of prioritisation with other areas of policy, we understand that the set-up and transition to the FSO will be delivered first. We would note that some of the aspects of the FSO's development – independence, expertise and a greater strategic or advisory role – would appear to align with the objectives of a Code Manager.

Q8: Are there any issues that we should take into account when considering moving the current 'code owner' licence provisions to the new code manager licence (such as unintended consequences)?

It is essential that any funding mechanisms for central system delivery bodies do not act as a hindrance to delivering code change. These bodies will need sufficient regulatory flexibility to digitise and enhance systems to support the programmes of the Strategic Body and Code Managers, in order to realise the consumer benefit of these changes.

Furthermore, considering including time provisions within the license provisions will incentivise change to happen by that date, alert and set industry up for the change.

Q9: What do you think the stakeholder advisory forums' key roles and/or functions should be, and what areas (other than code change) should the forum(s) potentially have a role in?

The role of Stakeholder Advisory Forums should be to gather input from across industry in order to understand the impacts of proposed changes to the code to different sectors. It should be an opportunity for the Code Manager to raise and test new ideas, and for stakeholders to offer a robust challenge to Code Managers. It should also be a forum for Code Managers to communicate progress on code changes with industry and to test the priority of changes that have been proposed. These elements should be used to inform decisions regarding code changes, noting that industry may disagree. We consider that engagement should be a key success criteria for a Code Manager as effectiveness of stakeholder input will remain a key feature of any new governance process.

Q10: What options/issues should be considered in terms of constituting the stakeholder advisory forum(s), in terms of membership and securing appropriate representation?

We have provided thoughts previously in our consultation responses in 2019[2] and 2021[3] and have further built on these below.

The stakeholder advisory forums should ensure we are able to maintain the best cocreation aspects of the current code modification processes. This will support engagement across industry and enable us to achieve Net zero together. Further time is needed to develop the detail on which parts should be retained and enhanced as well as the mechanics of how they would function but should include:

- Input into strategic decision making (currently Panels); The panels are typically made up of those with much industry experience which will be valuable in determining strategy directions and understanding the impact on different parts of industry. It will be important to retain this experience and input in order to ensure industry are strategically aligned to Net Zero ambitions. A strong Chairperson from the Code Manager should also lead the Stakeholder Advisory Forums to ensure that all parties and views are represented.
- Input into detailed development of code modifications (currently Workgroups); involving affected parties in a process when developing a modification, results in a change that is usually proportionate and achievable. There is also some technical and commercial information which is only available to certain parties e.g. costs, which is essential in carrying out a cost benefit analysis.
- Development forums (currently TCMF and GCDF etc); it is important that the SAF provides a way to discuss and debate new ideas from industry similar to the way development forums work today. It is also a great platform to inform stakeholders of changes or share best practices.

Incentives and Resource constraints

Code Managers should be incentivised to co-operate and develop plans with stakeholder input while taking care in setting any requirements that this does not unduly reduce their ability to make timely decisions. Without this incentivisation and knowing that their input will be heeded there is a real risk that stakeholders may see diminishing returns and may resolve to target their lobbying towards ultimate decision makers (i.e. Ofgem) resulting in a less efficient and considered change process.

It is unlikely that small parties can afford the resources to support the stakeholder engagement required and the role of trade organisations is likely to be imperative. Consideration for funding therefore across different sectors should be considered to ensure fair representation from across industry.

Experience and fresh perspectives

It may be appropriate to consider an application process to ensure that the membership is made up of those with the right expertise and knowledge. Quoracy should also be a key consideration to ensure that all sectors are represented at each meeting to hear as wide a range of views as possible including consumers. We would also encourage using technology to facilitate significant engagement rather than limiting membership to ensure the forums are diverse and inclusive of all sectors of industry.

In order to also ensure there is a fresh perspective on issues, consideration of a revolving membership should also be explored.

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[2] https://www.nationalgrideso.com/document/153051/download
[3] The 2021 response was not published.

Q11: Are there any lessons learnt (either good or bad) from the current code arrangements that should be considered?

Summary

There is a very strong core of industry organisations that currently participate within the code modification process providing essential commercial and technical expertise. It is essential to maximise the value added by these parties and others alongside successful reform of the governance arrangements to accelerate the pace of change and contribute towards delivering net zero.

The involvement of industry from a governance perspective is the piece that we feel is slowing down the progress of change, and leading to a lack of strategic delivery. We consider an example of this in the detailed response below.

The competing objectives of the market can cause participants, in some instances, to propose modifications or suggest alternatives, analysis needs, or minor issues within the workgroup process, to prolong the discussions within and thus progress of modification proposals.

An empowered independent Code Manager that uses Stakeholder Advisory Forums effectively would take advantage of the wide expertise offered by industry parties whilst speedily bringing changes to fruition.

We have provided feedback on this aspect in our previous responses as referenced in the question above.

There are many positive aspects to the current system that should be considered:

Range & expertise of SMEs - SME contribution to the Panel and Workgroups is incredibly important to the running of the code modification process and support solutions being developed that work across industry. This is currently the biggest value that is obtained through the code change process as industry can provide technical, commercial, or operational perspectives that are different to those of the system operator, although subject to commercial drivers.

Industry engagement in the process - the energy industry is highly engaged in the code change process and we would want to ensure the industry engagement remains high. This needs to be maintained through incentivising industry to contribute, through funding for smaller parties as discussed in the above question and ensuring that the Stakeholder Advisory Forums have a direct input into development of changes without slowing down the governance process. If incentivisation is not enough, it may be worth considering amending the licenses of industry to include an obligation to engage proactively and productively with the relevant Code Managers.

There are also some aspects that hamper progress and lead to inefficiencies that should be noted:

Cross code working- there is an increasing number of modifications that have an impact across the codes. This prolongs the modification process as the modification needs to go through multiple governance routes in order for a decision to be made.

Speed - if a modification requires a Workgroup, on average in the last 2 years it takes over a year to progress through the relevant stages and be submitted to Ofgem for approval[4]. Across the same period of time the average number of workgroups required has been 8.

The average value however disguises the number of workgroups and time taken to progress more complex modifications. Some examples are CUSC modification CMP315/375 which has had 17 workgroups and Grid Code GC0117 that has had 18 workgroups and neither of these modifications has yet concluded.

These are not outliers, there are other multiple modifications that have a similar number of workgroups.

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[4] Data runs from 2021-2023 and covers the CUSC, Grid Code and STC.

This data shows how the current process is slow and cumbersome. In many cases straight-forward issues, like co-location could be dealt with much more quickly, and not require industry input to rectify if a Code Manager were in place.

Due to the open governance framework, in the last five years there have been instances where Panel have had to prioritise modification progression due to industry and Code Admin resource e.g. Targeted Charging Review (TCR) when c.10 modifications were put on hold across commercial and technical codes.

Complexity - for new entrants to the market, the codes and code change process is complex and difficult to understand and engage with in a meaningful way. There are multiple governance routes, urgency criteria and processes that differ across the codes.

With the use of the codes as legal documents there is often pressure to give greater legal certainty by putting more detail in rather than taking it out. Additionally not all parties are able to engage with the process, so when legal text is developed and is positioned at a high level, only the members of the workgroup are likely to understand their obligations. This is a barrier for parties who couldn't engage during the workgroup and therefore do not have the context needed to understand their obligations.

Competing Objectives – commercial organisations fundamentally have different objectives to the consumer and thus proposed changes are focused on improving their commercial position rather than consumer value for money and Net Zero. There are examples from workgroups where members can lobby for positions that are beneficial to their organisations, without providing data and when requested, will state that it's commercially sensitive. We do note that commercially sensitive data can be provided to Ofgem in this instance who may use this information to inform their decision.

There are multiple instances as well where a workgroup's progress is held up by a small subset from the same industry who are all vying for the same outcome rather than the benefit of the consumer. This is well evidenced through CMP317/327 which required the development of 83 Workgroup Alternative Code Modifications (WACMs) each with parallel legal challenges that took up significant time and effort across industry and the regulator. Noting that for each of the 84 alternatives a full solution complete with legal text was required. This created a monumental effort to draft the legal text, check it was accurate, and for workgroup members to understand the effects of the change even though a substantial proportion of the modifications proposed did not comply with the Direction given by Ofgem at conclusion of their Targeted Charging Significant Code Review.

Lack of overall strategic direction for each code - given that any party can present a proposed modification at any time, there is a distinct lack of control and ownership over the long-term strategic direction of each individual code. This is then compounded with the above point around interference in the process from commercial organisations.

Commerciality and risk incentivisation – organisations represented within code panels and workgroups will look to remove any commercial disadvantage or legal risk from code development. While understandable, this can increase the complexity of solutions and the time that it takes to achieve them, while not necessarily achieving the best outcome for consumers.

Lack of agility in governance – there is a lack of flexibility within the current process which means industry is not able to engage proportionately to the proposals to ensure efficiency. Much time is spent on multiple consultations when in many modifications few responses are received outside of views already recorded within the workgroup report.