

## Appendix 19.2: Codes remedy package – remedies that we have decided not to move forward

### Introduction

1. We found that a combination of features of the wholesale and retail gas and electricity markets in GB relating to industry code governance gives rise to the Codes AEC through limiting innovation and causing the energy markets to fail to keep pace with regulatory developments and other policy objectives (see Section 18). In particular, we believe that the Codes AEC has the impact of limiting pro-competitive change. The underlying features of the Codes AEC are the following:
  - (a) parties' conflicting interests and/or limited incentives to promote and deliver policy changes; and
  - (b) Ofgem's insufficient ability to influence the development and implementation phases of a code modification process.
2. In our Remedies Notice, we outlined the aspects of the code governance regime which we considered might need to be reformed to address the AEC that we found. We proposed the following three separate remedies that, in our view, each contributed to addressing the underlying features of the AEC set out above:
  - (a) Remedy 18A: recommending to DECC to make code administration and/or implementation of code changes a licensable activity.
  - (b) Remedy 18B: granting Ofgem more powers to project-manage and/or control the timetable of the process of developing and/or implementing code changes.
  - (c) Remedy 18C: appointing an independent code adjudicator to determine which code changes should be adopted in the case of dispute.
3. In our provisional decision on remedies, we provisionally decided not to pursue Remedy 18B and Remedy 18C (both as set out in the Remedies Notice). Set out below are the parties' responses and the analysis that we took into account in deciding not to pursue those two remedies.

## Parties' views

### ***Views on the grant to Ofgem of executive powers to draft code changes and set timetables***

4. This proposed remedy aims to provide Ofgem with the powers to direct code changes and introduce mandatory timetables so that it can ensure that key modification proposals that further consumers' interests or impact competition are developed and implemented in a timely and efficient manner.
5. A majority of respondents (across all categories of respondent) did not support this remedy, with three criticisms raised in particular. Firstly, some respondents (Good Energy, ICOS, [X], Engie) argued that this proposed remedy would not add value as it would essentially lead to a duplication of Ofgem's current powers under the Significant Code Review process. Those respondents noted that the net impact of this proposed remedy would be to increase the level of uncertainty and bureaucracy surrounding the code modification arrangements. Secondly, some respondents (Ofgem, Scottish Power, Ecotricity) stated that they were concerned that Ofgem may not have a sufficient level of detailed technical expertise to undertake a greater level of responsibility in relation to the development of code modifications. Thirdly, some respondents (EDF Energy, SSE) were concerned that this change would increase regulatory risk as a result of undermining the ability of industry participants to appeal Ofgem decisions in this context. In addition, EDF Energy stated that the current approach and role of industry and code administrators meant that the risk of unintended consequences was minimised, resulting in a better outcome for consumers.
6. Ofgem noted two additional reasons as to why it was not appropriate for it to perform the expanded role contemplated by this remedy. Firstly, responsibility for project managing the development and delivery of individual modification proposals did not sit naturally within Ofgem's functions as an economic regulator. Secondly, allocation of this role to a licensee would be preferable as, in that case, there would be strong accountabilities against which performance could be measured and enforced.
7. Notably, each of the respondents (Centrica, SSE, E.ON) that indicated some form of support for this proposed remedy stated a preference that a much more limited version of the remedy be taken forward. Where Ofgem does have powers to raise its own code modification, Centrica considered it important that industry had the ability to appeal 'on the merits' of the case. Some of those respondents felt that the proposed remedy should merely grant Ofgem additional powers to intervene in order to establish indicative or mandatory timetables in certain, more limited ranges of circumstances, such

as for those modifications which have been raised as a result of the SCR process. Other of those respondents argued that Ofgem could add value by providing some form of 'strategic direction' to the industry in relation to Ofgem's desired direction for code development.

### ***Views on the creation of an independent code adjudicator***

8. The aim of this proposed remedy is to streamline the approval stage of the modification process by transferring responsibilities during that stage from Ofgem to a newly created code-specific adjudicator.<sup>1</sup>
9. Almost all respondents responded negatively or in a lukewarm fashion to this proposed remedy (and some parties appeared to be unclear about the role and purpose of the proposed new body). Only RWE, SSE and EDF Energy supported the idea in principle, but made clear in their respective responses that they would need more detail on the remit of the proposed adjudicator to reach a final view on the matter. RWE has suggested that an independent code adjudicator, separate but working with a new entity dedicated to project managing code changes, should be appointed to make decisions on change and to take on the role currently carried out by Ofgem in relation to industry code modifications. In addition, EDF Energy stated that it could not support the remedy at this stage as the creation of a code adjudicator would bring additional cost, and risk unintended consequences.

### **Our assessment**

#### ***Why we have not moved forward with Remedy 18B***

10. As stated in our Remedies Notice, the aim of this possible remedy was to grant Ofgem powers to intervene directly in the development and/or implementation of code changes in order to enable it to pursue consumers' interests and project-manage code modification processes, as appropriate.
11. After further consideration of this possible remedy, we decided that there are issues relating to its proportionality in the light of our Codes AEC finding.
12. In response to this possible remedy, a number of respondents submitted to us that they had concerns relating to Ofgem's ability to direct code changes. In particular, Ofgem put to us that it does not have the capacity or the appetite to play a greater role in governing codes through an enhanced SCR process. In

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<sup>1</sup> This remedy is based on a submission by RWE in response to our provisional findings that queried whether Ofgem is the appropriate body to evaluate code changes given that it must act according to a statutory basis which encompasses issues not clearly related to the codes (eg sustainability, security of supply).

addition, various parties (including Ofgem) have stated that resource-intensive SCRs are not an efficient use of Ofgem's expertise or scarce capacity. They claim that Ofgem's capacity could be better leveraged if it were employed in the task of providing the industry with an early steer concerning Ofgem's expectations of:

- (a) the code changes (across all codes) it views as important to further the interests of consumers and/or competition; and
- (b) the scope of analysis required during the development stage of key modification proposals.

13. We note that this remedy proposed to address the underlying features of the Codes AEC by granting additional powers to Ofgem. On the basis of our analysis and submissions put to us by several parties, we consider that the aim of this possible remedy would not facilitate the resolution of either of those features. Moreover, we consider that it is feasible to implement an effective solution to the Codes AEC without including this possible remedy. Therefore, implementing this remedy would also be disproportionate.

#### ***Why we have not moved forward with Remedy 18C***

14. As stated in our Remedies Notice, the aim of this possible remedy was to streamline the approval stage of the modification process by reducing the number of disagreements occurring between the industry and the decision maker. Pursuant to this possible remedy, decision-making authority during the approval stage would be transferred from Ofgem to a new 'code adjudicator' created for that purpose.
15. After further consideration of this possible remedy, we decided that there are issues relating to its underlying rationale as well as to its proportionality in the light of our Codes AEC finding.
16. RWE's main comment in support of a new code adjudicator was that decisions on code changes should only be assessed against the relevant code objectives and not the broader issues contemplated by Ofgem's statutory basis. In all other contexts, Ofgem must take its statutory basis into account when making decisions. For this reason, we consider that restricting Ofgem's decisions on code changes in the way contemplated by this remedy would run contrary to our wider aim of ensuring a predictable regulatory framework. In addition, this change would introduce a risk that the codes could develop in a manner inconsistent or even contradictory to the wider regulatory regime.

17. We also recognise that there are efficiency gains from having a decision maker that has some degree of involvement in the modification process prior to the approval stage.
18. With regards to the proportionality of this remedy, we note that this remedy proposed to address the underlying features of the Codes AEC by changing the decision maker responsible for approving code changes. On the basis of our analysis and submissions put to us by several parties, we consider that the aim of this possible remedy would not facilitate the resolution of either of those features. Moreover, we consider that it is feasible to implement an effective solution to the Codes AEC without including this possible remedy. Therefore, implementing this remedy would also be disproportionate.