



Department for  
Energy Security  
& Net Zero

**ofgem**

Making a positive difference  
for energy consumers

# Energy Code Reform: Consultation on Code Manager Licensing and Secondary Legislation

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March 2024



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# Executive Summary

Britain's energy sector continues to undergo significant technological, operational, and commercial change. The Government's 2019 legislative commitment to reach net zero emissions by 2050<sup>1</sup> has only increased the need for our national energy ecosystem to innovatively transform to meet this ambitious target. The transition to a low carbon energy system can only be achieved if the sector rules and governing institutions evolve to enable it. We need an electricity and gas system that is managed to allow challenges to be efficiently and effectively overcome, while empowering the uptake of new opportunities to ultimately benefit consumers.

The detailed rules contained in the gas and electricity industry codes play a key role in facilitating the energy market in Great Britain. Overseen by the independent energy regulator, the Office of Gas and Electricity Markets (Ofgem),<sup>2</sup> and governed by industry-led processes, the codes have been successful when dealing with an energy system that was more predictable and subject to incremental changes over time. However, we recognise that the existing code governance structure was not designed to deliver the proactive foresight and coordination that will be needed to meet the challenges of the evolving sector.

Our 2021<sup>3</sup> consultation and April 2022<sup>4</sup> response on energy code reform stated our intent to establish a regulatory regime for new 'code managers' as licensed bodies who would be responsible for the governance of industry codes. We also set out a new strategic role for Ofgem to provide direction for the codes' development, in line with government priorities, the need to transition to a net zero energy system, and the protection of consumer interests. The new code manager licensing arrangements aim to ensure that this strategic change can be delivered, effectively and efficiently.

Following the Energy Act 2023 receiving Royal Assent in October 2023, we are now developing the secondary legislation and regulatory framework for code managers, which will allow Ofgem to implement the reformed framework and drive strategic changes across the codes in the interest of consumers and competition.

In this joint consultation, the Department for Energy Security and Net Zero (the Department) and Ofgem, collectively referred to as "we" and "our" where relevant, set out our initial proposals for code manager standard licence conditions and selection processes. Key policy proposals covered in this consultation are summarised below.

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<sup>1</sup> Net zero legislative commitment (June 2019). Available at: <https://www.gov.uk/government/news/uk-becomes-first-major-economy-to-pass-net-zero-emissions-law>

<sup>2</sup> Ofgem is the Office of Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority (GEMA), the body established by section 1 of the Utilities Act 2000 to regulate the gas and electricity markets in Great Britain. In this document, Ofgem and GEMA are used interchangeably.

<sup>3</sup> Consultation on the Delivery and Delivery of the Energy Code Reform (September 2021). Available at: <https://www.gov.uk/government/consultations/energy-code-reform-governance-framework>

<sup>4</sup> Government response on Consultation on the Delivery and Delivery of the Energy Code Reform (April 2022). Available at: <https://www.gov.uk/government/consultations/energy-code-reform-governance-framework>

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## Code manager licence

We propose the high-level contents of the code manager licence. We have also developed policy on the following priority areas and seek views from stakeholders on our proposals, and the associated draft licence conditions in Annex A.

### 1. Not for profit requirement

We propose that licensed code managers will be required to carry out their core regulated business on a not-for-profit basis. We consider this will reduce the risk of profit maximising behaviour, ensuring code managers focus on the best outcomes under the code.

### 2. Setting code manager budgets

We consult on four options for how code managers budgets will be set, with a preferred option that code managers set their own budgets ahead of the year. We are proposing that the licence will include checks and balances to, for example, ensure that budgets are transparent, provide value for money, and that stakeholder views are considered.

### 3. Code manager funding and cost recovery

We present four options for how code managers could recover their costs, with a preference for Ofgem deciding on a code-by-code basis between either retaining existing code body cost recovery mechanisms or Ofgem developing a new cost recovery methodology. We propose that the licence would require the code manager to comply with the cost recovery methodology set out in the code, and to develop annual cost recovery statements.

### 4. Code manager incentivisation

We propose that instead of having financial performance incentives, code managers will be required by the licence to set performance metrics in consultation with stakeholders, and to report publicly on their performance against those metrics.

### 5. Conflicts of interest and independence

We propose including licence conditions designed to mitigate the risk of potential bias and conflicts of interest, and to ensure sufficient accountability and independence. This includes ensuring that code managers do not unduly prefer themselves or affiliates when making decisions and recommendations on code modifications. The proposed licence conditions include requirements to not unduly discriminate, restrictions on the activities the code manager is allowed to undertake, and a requirement to have sufficiently independent directors in place.

### 6. Financial and operational controls

We propose that the code manager licence will include requirements to ensure that code managers have in place adequate financial and operational resources to carry out the code manager role. As well as requirements for the code manager to provide assurance on availability of resources, these conditions include restrictions designed to minimise risks that could jeopardise the financial stability of code managers.

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## 7. Code maintenance and modification

We propose that code managers will become responsible for maintaining the relevant codes, which would result in consequential changes to existing licences in due course. We also set out certain provisions related to code governance, including that there will be licence obligations on code managers to have Stakeholder Advisory Forums in place.

### Code manager selection

We set out our proposals for secondary legislation that will underpin Ofgem's code manager selection processes, including who will be eligible for selection, how Ofgem will determine whether to pursue competitive versus non-competitive selection for each code, and how any non-competitive selection process would work. We also set out a view that the proposed selection route criteria – speed of delivery and value for money – may lead Ofgem to pursue non-competitive selection in many cases, such as where a code has not been consolidated and an eligible incumbent body already exists.

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# General Information

## Why we are consulting

We are seeking the views of interested parties, including existing code parties, wider industry players, consumer groups, code administrators, and academics on our proposals for code manager selection regulations and licence conditions, following Royal Assent of the Energy Act 2023.

Feedback has been gathered from previous consultations in 2019 and 2021 on the design and delivery of energy code reform, and from six stakeholder workshops that we held in May and June 2023. This consultation follows on from these publications and workshops.

## Consultation details

**Issued:** 11 March 2024

**Respond by:** 5 May 2024

**Enquiries to:**

Code Governance Reform Team, Department for Energy Security and Net Zero, 7th Floor, 3-8 Whitehall Place, London, SW1A 2EG

And

Code Governance Reform Team, Office of Gas and Electricity Markets, 10 South Colonnade, Canary Wharf, London E14 4PU

Email: [codereform@energysecurity.gov.uk](mailto:codereform@energysecurity.gov.uk) and [industrycodes@ofgem.gov.uk](mailto:industrycodes@ofgem.gov.uk)

**Consultation reference:** Energy Code Reform

**Audiences:**

Code parties, code administrators, consumer groups, energy sector research groups and any other organisations with a direct interest.

**Territorial extent:** Great Britain



## How to respond

The consultation is available online. If possible, we would prefer to receive responses via the following link: <https://energygovuk.citizenspace.com/energy-security/energy-code-reform-manager-licensing>

If you would prefer to respond via email, please ensure you respond to both email addresses below and use the response form available on the GOV.UK consultation page: <https://www.gov.uk/government/consultations/energy-code-reform-code-manager-licensing-and-secondary-legislation>.

**Email to:** [codereform@energysecurity.gov.uk](mailto:codereform@energysecurity.gov.uk) and [industrycodes@ofgem.gov.uk](mailto:industrycodes@ofgem.gov.uk)

If you would like to send a hard copy, please send copies to the following addresses. As this is a joint review, please ensure you send copies to both addresses below.

### Write to:

Code Governance Reform Team, Department for Energy Security and Net Zero, 7th Floor, 3-8 Whitehall Place, London, SW1A 2EG

And

Code Governance Reform Team, Office of Gas and Electricity Markets, 10 South Colonnade, Canary Wharf, London E14 4PU

The Department and Ofgem will share with each other all responses that are received.

When responding, please state whether you are responding as an individual or representing the views of an organisation.

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome.

## Confidentiality and data protection

Information you provide in response to this consultation, including personal information, may be disclosed in accordance with UK legislation (the Freedom of Information Act 2000, the Data Protection Act 2018 and the Environmental Information Regulations 2004).

Ofgem and the Department are joint data controllers for this consultation.

All responses will be processed by the Department and Ofgem as this is a joint consultation: read [our consultation privacy notice](#).

We will summarise all responses and publish this summary on [GOV.UK](#). The summary will include a list of names or organisations that responded, but not people's personal names, addresses or other contact details. If you want the information that you provide to be treated as confidential, please tell us and explain the reason. Please clearly mark the parts of your response that you consider to be confidential and, if possible, put the confidential material in separate appendices to your response.

Please be aware that we cannot guarantee confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not be regarded by us as a confidentiality request.

We will process your personal data in accordance with all applicable data protection laws. See our privacy policy.

## Quality assurance

This consultation has been carried out in accordance with the government's [consultation principles](#).

If you have any complaints about the way this consultation has been conducted, please email: [bru@energysecurity.gov.uk](mailto:bru@energysecurity.gov.uk).

# Introduction

## Background

The detailed rules of participation in the gas and electricity markets are contained within a set of industry codes. They are overseen by the independent energy regulator, the Office of Gas and Electricity Markets (Ofgem),<sup>5</sup> and governed by industry-led processes. The existing code governance arrangements have been successful when dealing with an energy system that was more predictable and primarily subject to incremental changes over time. However, the Competition and Market Authority's (CMA) 2016 Energy Market Investigation<sup>6</sup> found that the current system of energy code governance was having an adverse effect on competition, stemming from, among other things, conflicting interests, lack of incentives to carry out policy changes, and Ofgem's limited ability to influence the code change process.

In response, the government and Ofgem jointly conducted a review of industry code governance. Our 2019 joint consultation<sup>7</sup> gathered initial views on potential reforms to the code governance arrangements, primarily on providing strategic direction for the codes, licensed code management, independent decision-making, and code simplification. The 2020 government response<sup>8</sup> stated support for a new institutional governance model that would introduce a new strategic function and a separate code manager function.

In 2021, we consulted on our preference for Ofgem taking on this strategic function, rather than introducing a new body for this purpose. We also confirmed that we would introduce licensed code managers, who would undertake current code panel and code administrator roles, as well as having an enhanced role in the code change process, including delivering change in line with the strategic direction set by Ofgem. A key element of this proposal is that new code managers would be supported in their role by industry stakeholders through Stakeholder Advisory Forums.

These reforms aim to create a code framework that:

- is forward-looking, informed by and in line with the government's ambition and the path to net zero emissions, and ensures that codes develop in a way that benefits existing and future energy consumers
- is able to accommodate a large and growing number of market participants and ensure effective compliance
- is agile and responsive to change whilst able to reflect the commercial interests of different market participants to the extent that this benefits competition and consumers, and

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<sup>5</sup> Ofgem is the Office of Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority (GEMA), the body established by section 1 of the Utilities Act 2000 to regulate the gas and electricity markets in Great Britain. In this document, Ofgem and GEMA are used interchangeably.

<sup>6</sup> CMA Energy Market Investigation: Final report (June 2016). Available at: <https://www.gov.uk/cma-cases/energy-market-investigation>

<sup>7</sup> Consultation on Reforming the Energy Industry Codes (September 2019). Available at: <https://www.gov.uk/government/consultations/reforming-the-energy-industry-codes>

<sup>8</sup> Government Response to the Consultation on Energy Code Reform (April 2020). Available at: <https://assets.publishing.service.gov.uk/media/624c8916d3bf7f32b499add4/energy-code-reform-consultation-government-response.pdf>

- makes it easier for any market participant to identify the rules that apply to them and understand what they mean, so that new and existing industry parties can innovate to the benefit of energy consumers.

The Energy Bill, introduced to Parliament in July 2022, set out measures for the reformed gas and electricity code governance framework. Alongside the Bill's progression, in May and June 2023, we hosted several workshops with industry stakeholders to discuss and gather views on key aspects of the proposed regulatory framework for code managers. These included how Ofgem should assess code manager candidates, possible code manager selection processes, and approaches to code manager budgets, charging and incentives. Following the Energy Act 2023<sup>9</sup> receiving Royal Assent in October 2023, we are now consulting on the secondary legislation and regulatory framework for code managers, which will allow Ofgem to implement the new code governance arrangements and drive strategic changes across the codes in the interest of consumers and competition.

Ofgem is currently consulting on their approach to implementing code governance reform, using transitional powers provided in the Energy Act 2023.<sup>10</sup>

## Consultation Forward Look

This consultation builds on the previous energy code reform publications mentioned above. Our proposals and positions herein have resulted from our own internal analysis, in addition to extensive engagement with industry, consumer groups, and cross-government stakeholders, spanning a range of sectors and jurisdictions.

To support our development of the regulatory framework for code managers we undertook six workshops over May and June 2023 which focused on gathering views from industry stakeholders to inform our initial development of code manager selection processes and licensing arrangements. We summarise views expressed at these workshops where relevant throughout this consultation. Separately, Ofgem published a call for input on code governance reform in December 2022<sup>11</sup> and, where relevant, we refer to views that were expressed in the call for input responses.

The document is ordered into chapters, each of which covers one primary policy area and contains our related proposals and a set of questions that we seek your views on. The final two chapters provide an overview of planned next steps and a recap of all the consultation questions.

The policy chapters are as follows:

- **Chapter 1:** Code manager licence
- **Chapter 2:** Not-for-profit requirement
- **Chapter 3:** Setting code manager budgets
- **Chapter 4:** Code manager funding and cost recovery

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<sup>9</sup> Energy Act 2023 (October 2023). Available at: <https://www.legislation.gov.uk/ukpga/2023/52/contents/enacted>

<sup>10</sup> Energy code reform: implementation consultation, Ofgem (January 2024). Available at: <https://www.ofgem.gov.uk/publications/energy-code-reform-implementation-consultation>

<sup>11</sup> Energy Code Governance Reform: Call for input, Ofgem (December 2022). Available at: <https://www.ofgem.gov.uk/publications/energy-code-governance-reform>

- **Chapter 5:** Code manager incentivisation
- **Chapter 6:** Conflicts of interest and independence
- **Chapter 7:** Financial and operational controls
- **Chapter 8:** Code maintenance and modification
- **Chapter 9:** Code manager selection

In Annex A we attach draft licence conditions related to Chapters 3-8.

We invite stakeholder views to inform the development of the code manager selection regulations, and the code manager standard licence conditions set out in this consultation.

A full set of draft licence conditions, and associated policy proposals, will be consulted on in due course. We will also consider policy options for updating the process for appeals to the Competition and Markets Authority (CMA) on Ofgem's code modification decisions, as set out in Statutory Instrument 2014 No. 1293 The Electricity and Gas Appeals (Designation and Exclusion) Order 2014.<sup>12</sup>

We have decided not to make regulations under the Energy Act 2023 related to Ofgem's strategic direction statement<sup>13</sup> or Ofgem's power to make direct code changes<sup>14</sup> at this time.

## High level implementation plan

This consultation forms a key part of the overall implementation plan for code governance reform,<sup>15</sup> which involves activities led by both the Department and Ofgem.

An overview of the anticipated stages for code reform implementation is set out in Figure 1 below, which identifies key steps to the commencement of the first code manager licence(s).

Ofgem is currently consulting on their approach to transitioning the codes to the new governance arrangements.

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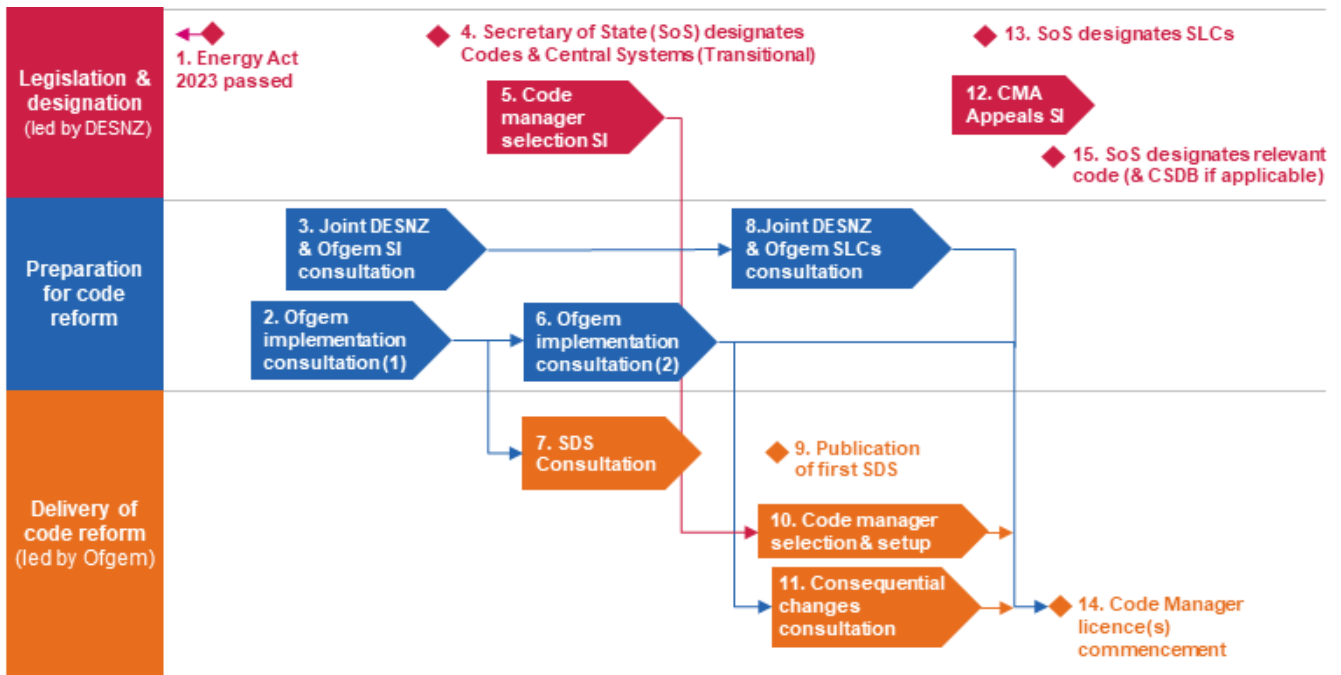
<sup>12</sup> The Electricity and Gas Appeals (Designation and Exclusion) Order 2014 (June 2014). Available at: [http://www.legislation.gov.uk/uksi/2014/1293/pdfs/uksi\\_20141293\\_en.pdf](http://www.legislation.gov.uk/uksi/2014/1293/pdfs/uksi_20141293_en.pdf)

<sup>13</sup> Energy Act 2023 – section 190 (October 2023). Available at: <https://www.legislation.gov.uk/ukpga/2023/52/part/6/crossheading/strategic-direction-statement-for-designated-documents/enacted>

<sup>14</sup> Energy Act 2023 – section 192 (October 2023). Available at: <https://www.legislation.gov.uk/ukpga/2023/52/section/192/enacted>

<sup>15</sup> This consultation is represented in chevron numbered 3.

Figure 1: High level implementation plan



# 1. Code Manager Licence

Industry code governance is currently managed by code panels and supported by code administrators. Under our reforms, Ofgem will license code managers who will become responsible for the governance of designated codes in accordance with the Energy Act 2023 ('the Act'). Code managers will play a central role in ensuring we deliver the aims of code governance reform. They will be established and licensed in a way that ensures they govern codes in an independent and impartial manner and will be responsible for ensuring that the codes develop in line with Ofgem's new Strategic Direction Statement<sup>16</sup>. The strategic direction will set out Ofgem's vision for how the codes should evolve, based on its strategic assessment of government policies and developments relating to the energy sector that will, or may, require modifications to the designated industry codes. The strategic direction, in conjunction with licensed code managers, will play a critical role in ensuring the effective and co-ordinated development of the code changes needed to deliver on net zero ambitions and broader benefits to consumers through the energy transition. Industry stakeholders will retain a key role in the code processes, with new Stakeholder Advisory Forums formed to inform code managers' decision-making. This will ensure that the vital expertise and knowledge held by industry participants can be harnessed by code managers when delivering their plans to align codes with Ofgem's strategic direction.

The Energy Act 2023 introduced code management as a licensable activity.<sup>17</sup> Table 1 below sets out a high-level summary of the main features of the code manager role.

**Table 1: Code Manager Role Features**

Make decisions under the codes	Administer code governance arrangements	Align code with Ofgem's strategic direction
<p>Including prioritising modifications, deciding whether to approve certain code changes<sup>18</sup> and making recommendations to Ofgem on whether to approve others.</p> <p>Other decisions will include those not directly related to code modifications, such as on (depending on the code) accession, performance assurance, innovating party IDs etc.</p>	<p>Provide code administration and secretariat services to, amongst other things, facilitate the code modification procedures and provide assistance to code parties and stakeholders (including consumer advocates) relating to the code.</p>	<p>Prepare delivery plans setting out how they will ensure their respective codes develop in line with the 'strategic direction' set by Ofgem.<sup>19</sup></p> <p>Identify and develop relevant code changes through proposing code modifications.</p>

<sup>16</sup> Section 190 of the Energy Act 2023 covers the requirements under the Strategic Direction Statement.

<sup>17</sup> Sections 185 and 186 of the Energy Act 2023 introduced the prohibition on, and licensing framework for, code management of designated codes.

<sup>18</sup> E.g. modifications that would be classified as 'self-governance' under existing modification arrangements.

<sup>19</sup> The delivery plans may also include information on the code managers broader plans, e.g. also covering code changes or other planned activities not directly related to the strategic direction.

Licences for code managers will follow a similar structure to existing gas and electricity licences, with a set of standard licence conditions which apply to all holders of the code manager licence,<sup>20</sup> and potentially special conditions which apply to a particular licence holder. Ofgem are leading the development of the standard licence conditions, working jointly with the Department, prior to designation of the standard licence conditions by the Secretary of State (SoS).

In developing the licence content, we expect that some obligations will be set out at a high level in the licence, with further detail in the relevant code (or potentially in other documents, such as a guidance document referred to in the licence), and that licence obligations may be a combination of prescriptive and principles based.

## 1.1. Stakeholder engagement on licence content

Ofgem's December 2022 call for input<sup>21</sup> sought views on a high-level list of content for inclusion in the code manager licence. The focus was on identifying the broad areas of licence content to be developed, as opposed to seeking views on the detailed policy questions that will arise under each area. It also proposed priority areas for policy development. Of those who provided a view, the majority of respondents supported Ofgem's proposed priority areas, with some making suggestions for additional areas to prioritise. Having considered these responses, and the feedback provided at our subsequent stakeholder workshops in May and June 2023, the areas of the licence that we have initially prioritised and are now consulting on are:

- Not for profit requirement
- Setting code manager budgets
- Code manager funding and cost recovery
- Code manager incentivisation
- Conflicts of interest and independence
- Financial and operational controls
- Code maintenance and modification

We are also consulting on the overall contents of the code manager licence conditions ('the licence skeleton'), ahead of policy development and consultation on the licence content that is not covered in this consultation.

The proposals for the code manager licence conditions have been informed by responses to Ofgem's December 2022 call for input and the stakeholder workshops.

We have provided, in Annex A, draft proposed licence conditions to reflect our policy proposals below. For each policy area, we seek feedback from stakeholders on whether the licence drafting delivers our proposed policy.

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<sup>20</sup> Standard conditions may also be modified for a particular licence holder.

<sup>21</sup> Energy Code Governance Reform: Call for input, Ofgem (December 2022). Available at: <https://www.ofgem.gov.uk/publications/energy-code-governance-reform>



## 1.2. Overview of the licence – the ‘licence skeleton’

In Ofgem’s December 2022 call for input, Ofgem identified 17 areas of licence content grouped under the following categories:

- Governance and conduct
- Funding and incentives
- Deliverables and reporting

Having considered responses to Ofgem’s December 2022 call for input, we summarise our current views on the overall licence content below, which we refer to as the ‘licence skeleton’. While we acknowledge that this may further evolve as we progress detailed policy development and licence drafting, we are seeking input to identify whether there may be additional areas for consideration. We anticipate consulting on the full set of code manager licence conditions next year.

## 1.3. Stakeholder views

Ofgem’s December 2022 call for input asked stakeholders if they saw any of the contents identified for the licence conditions as unnecessary, or if they would be more effectively covered outside the licence (e.g., in the codes). The majority of those who responded to this question broadly agreed with the identified licence contents. Additionally, many indicated support for a “light-touch licence” and having more detail in the codes. Some respondents noted that some of the proposed conditions are already covered in the codes. One specific example given was dispute resolution. It was also suggested that some proposed conditions are addressed elsewhere, such as under company law or by good governance practices (this is relevant to our proposals to include licence content related to effective corporate governance and risk management).

Ofgem also sought input on any additional areas that should be subject to licence rules. Many did not raise any additional areas. The most common proposed addition was an obligation on the code manager to ensure the efficient delivery of the code and code modifications. Also, there were various suggestions around placing overarching objectives on the code manager, including in relation to delivering consumer benefits, enabling net zero and delivering on an agreed strategy. In response to feedback, we have added to the licence skeleton a proposed condition (for future consultation) titled “The relevant business of the licensee and any general objectives” that sits in the section on “Nature and conduct of the Licensee’s business”.

Some stakeholders pointed out the importance of, and suggested detail around, the licence obligations on engaging with stakeholders. We agree that the licence should contain conditions relating to stakeholders and in this consultation we include proposals on code manager licence obligations with regard to Stakeholder Advisory Forums in Chapter 8.<sup>22</sup>

Other suggestions gathered from the responses included code managers reporting on central system delivery body interactions, transitional arrangements (both in moving to the new

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<sup>22</sup> We set out a preferred approach for constituting Stakeholder Advisory Forums (SAF) in Ofgem’s implementation consultation. We expect code managers would be required to consult with SAFs ahead of making certain decisions.

arrangements and where one code manager is being replaced by another) and avoiding bias. We consider these are either sufficiently covered by the headline conditions proposed, will be addressed through the delivery of the strategic direction, and/or will sit better in other documents such as the relevant code.

## 1.4. Proposed licence skeleton

In Table 2, we set out the proposed licence skeleton organised by sections and content. The conditions highlighted in green (and marked with an asterisk) are those that we are consulting on as part of this consultation. Further details on these can be found in subsequent sections of this consultation.

Further to Ofgem’s December 2022 call for input, we have added (for consideration in a future consultation) a specific line relating to Ofgem having the ability to impose requirements against code manager board members, such as requiring their removal. We have titled this as ‘management orders for the licensee’ in the skeleton.

### The licence skeleton

**Table 2: Proposed Skeleton Licence Content**

Section	Licence condition content
Nature and conduct of the Licensee’s business	The relevant business of the licensee (and any general objectives)
	General controls of the business (inc. risk management, organisational structure and controls, corporate governance, any requirements on board structure/composition as well as any ongoing 'fit and proper' requirements regarding, e.g., directors of the code manager)
	Data handling <sup>23</sup>
Financial and operational controls	Availability of all necessary resources *
	Indebtedness and transfer of funds *
	Assurance of the financial stability of the licensee *
	Prohibition on cross-subsidies *
	Not-for-profit requirement *
Arrangements for the Licensee’s independence <sup>24</sup>	Prohibition on engaging in preferential or discriminatory behaviour *

<sup>23</sup> Ofgem are considering extending data best practice requirements to capture all licensees. We will consider the decisions made in this area as we develop our policy on code manager data handling.

<sup>24</sup> We are consulting on two additional prescriptive conditions (restrictions on directors’ affiliations and business separation requirements). We are uncertain if these conditions are appropriate and proportionate to the code manager role and licence, but we are keen to receive stakeholder views and input before deciding.

Section	Licence condition content
	Requirement to not prevent nor distort competition *
	Sufficiently independent directors *
	Restriction on activity and investment *
	Restriction on the licensee becoming a related undertaking *
	Ultimate controller undertaking *
	Protection of confidential information
	Compliance obligations <sup>25</sup>
Funding, charging and financial incentives	Budgets *
	Incentives and any links to revenues *
	Code manager cost recovery methodology *
	Code manager cost recovery statements *
Governance, including stakeholder engagement and cooperation	Code maintenance and modification *
	Cooperation and cross-code working
Planning, delivery, and reporting	Production of a delivery plan consistent with the strategic direction
	Complying with the delivery plan and reporting on progress
	Obligations towards Ofgem and the Department <sup>26</sup>
	Ease of use of the code
Arrangements for intervention and continuity	Transitional arrangements <sup>27</sup>
	Management orders for the licensee
	End of licence term arrangements, intellectual property rights, and code manager of last resort arrangements

<sup>25</sup> I.e., what is required for the code manager to demonstrate it is complying with independence requirements, e.g., what information it needs to have if the authority requests, what mechanisms needs to be in place etc.)

<sup>26</sup> This may include, for example, requirements to provide Ofgem and the Department with information upon request, and to comply with any directions Ofgem issues.

<sup>27</sup> Any generic condition for transitional arrangements that may apply in the early months or years of the licence, if required. Alternatively, such arrangements may be set out in special conditions, particular to an individual licensee.

## 1.5. Consultation questions

Please provide rationale for your answers to the below question:

- **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?**

## 2. Not-for-profit Requirement

In our previous consultations and government responses, we have not set out our view on whether the role of code management should be for profit or not-for-profit. Stakeholders nonetheless did raise the question of profit status. In response, we noted that we would design the framework in a way that allows for both for- and not-for-profit organisations to be eligible to become a code manager. The topic was also discussed at our June 2023 workshops. Below we summarise views from those workshops and then consider whether to require that code managers operate their core regulated business on a not-for-profit basis.

### 2.1 Stakeholder views

At our June 2023 workshops exploring the code manager selection regime, we asked questions relating to the types of characteristics that might affect a code manager's ability to carry out its role, the kinds of expertise that might be required, and what Ofgem should consider when deciding how to select a code manager. Several workshop participants indicated support for code managers being not-for-profit. It was also acknowledged that for-profit competition could help to drive efficiency, but that a for-profit model should not necessarily be prioritised at the expense of code manager impartiality.

### 2.2 Proposed approach

We are proposing to require code managers to operate on a not-for-profit basis. We propose to implement this through the proposed code manager budget and charging requirements, which would allow only for recovery of costs without a profit margin. This is further supported by a restriction on profit in the proposed financial and operational controls section of the code manager licence. Although this proposal would not explicitly rule out commercial entities from becoming a code manager, they would need to be willing to make any necessary arrangements to operate the core business on a not-for-profit basis and comply with related licence conditions.

We consider that this requirement will ensure that the code manager is motivated to deliver the best outcomes under the code, rather than being driven by profit-maximisation. We anticipate that most of the code manager expenditure will be on in-house resources, such as staff and IT systems, and we would not wish to see measures taken to reduce costs in these areas where it could be at the detriment to the delivery of its functions.

We also consider that the requirement will strengthen the code manager's accountability in its role, and that removing a code manager's ability to derive profits from its regulatory functions facilitates this. The code manager will be funded by code parties, and we believe it should draw on industry input when making decisions, rather than being influenced by outside shareholders (that may or may not be affiliated with the codes in question).

We recognise that this approach carries certain disadvantages, although we believe they can be mitigated. For example, the inability to make a profit may limit the interest of commercial entities in taking part in a selection process, which would narrow the potential code manager selection pool and reduce the viability of a tender selection process. However, we believe that Ofgem will still be able to select (or where necessary, create) suitable not-for-profit code managers (as set out in further detail in Chapter 9 on code manager selection). Ofgem will also

consider a form of competition based on factors other than cost where it perceives that this process would be beneficial, in line with the proposed decision-making framework set out in Chapter 9, below.

In addition, we are aware that some stakeholders support the benefits that a profit-making model can bring. Competitive pressures, such as cost efficiency, can potentially still be achieved under a not-for-profit model, for example if code managers subcontract certain functions via competitive procurement. To strengthen enforcement by Ofgem and ensure the code manager's independence and accountability, we are likely to establish (through the licence conditions) limitations on subcontracting, with some functions being required under the licence to be kept in-house (e.g., decisions on code modifications, board nomination, and budget setting). This will be addressed in a forthcoming consultation. The code manager licence will also need to be designed to reflect a not-for-profit regulatory model, including our proposal for performance incentives that do not result in higher or lower revenues, which is set out more in detail below. Performance would instead be managed via reputational incentives and through Ofgem's use of enforcement powers.

## 2.3 Proposed licence content

To ensure that code managers operate on a not-for-profit basis, we propose that the budget and charging requirements in the code manager licence will allow for recovery of costs and expenses incurred from carrying out the role,<sup>28</sup> but will not allow for a profit margin to be derived. We also propose that the licence will include a specific requirement to operate the licensed code manager business on a not-for-profit basis. This would not explicitly preclude commercial, for-profit entities from carrying out the code manager role, provided they take the appropriate steps to ensure that the regulated business operates on a not-for-profit basis and complies with the related licence conditions on conflicts of interest and financial controls.

In Annex A we include the not-for-profit licence condition as part of the Financial and Operational Controls section of the licence.

## 2.4 Consultation questions

Please provide rationale for your answers to the below questions:

**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?**

**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?**

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<sup>28</sup> We propose that this could include an allowance for recovery of a reasonable contingency amount to ensure budgets are stable and to cover unexpected events.

## 3. Setting Code Manager Budgets

Code managers will play a key strategic and operational role in the new energy code governance framework, and they will need to recover the costs of carrying out their role. As stated in the government response,<sup>29</sup> code managers will be funded through charges levied on code parties. To ensure code managers can recover their costs efficiently, and that budgets are subject to proper scrutiny, it is important that we consider the process of how budgets are developed, consulted on, and agreed.

The government response further stated that Ofgem should retain ultimate oversight of code manager budgets, but that this oversight could be lighter touch, perhaps in the form of a veto or step-in powers. We said that Ofgem will “ensure that budgets are developed in close consultation with industry, who will be well placed to scrutinise and challenge them.”<sup>30</sup>

To ensure transparency and accountability across the various codes, and to facilitate benchmarking of costs between code managers, we propose that the overarching mechanism by which code managers set their budgets should be set out in the licence, meaning that all code managers would be required to follow the same broad budget-setting process. However, we recognise that it may be appropriate to include some of the details of the budget-setting process in the relevant code.

We have examined various approaches to setting code manager budgets, considering previous stakeholder feedback as well as how similar monopoly service providers in the energy sector (including code administrators and system bodies) set their budgets and consult with stakeholders. In determining a preferred option, we took into account a number of core principles that we consider any budgeting process should meet. These were also informed by comments received from stakeholders in our workshops and responses to Ofgem’s December 2022 call for input (see ‘stakeholder views’ section, below). We have considered whether the potential approach:

- provides sufficient opportunity for code parties, other interested stakeholders, and Ofgem to scrutinise budgets
- ensures transparency of costs, including those related to external service providers
- ensures value for money and efficiency in the carrying out of code manager activities
- ensures stability and predictability of charges for code parties; and
- allows for flexibility, for example if costs change mid-period.

### 3.1 Summary of options

Below we present a summary of the four possible approaches to setting budgets and further explain the rationale for our preferred approach (option one):

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<sup>29</sup> Energy code reform: government response (April 2022). Available at:

<https://www.gov.uk/government/consultations/energy-code-reform-governance-framework>

<sup>30</sup> Energy code reform: government response [page 43] (April 2022). Available at:

<https://www.gov.uk/government/consultations/energy-code-reform-governance-framework>

- Option one: code managers set their own budgets ahead of year
- Option two: ex-post budget controls<sup>31</sup>
- Option three: ex-ante budget controls<sup>32</sup>
- Option four: budgets agreed by Ofgem at selection

## 3.2 Stakeholder views

Ofgem's December 2022 call for input indicated that requirements in the code manager licence may include how the budget will be set (including frequency, process, and any role for Ofgem and/or other stakeholders in budget setting and scrutiny), and restrictions on what the budget can be spent on.

Thirteen respondents provided comments on potential budget-setting requirements. Views expressed included:

- the detail of the budget-setting framework should be set out in codes, rather than in the licence
- the licence should include minimum standards for budgets, or budget objectives
- the licence should include specific requirements for code managers to consult with stakeholders on their budgets
- there is a role for stakeholder advisory forums<sup>33</sup> (SAFs), for example, the SAF could critique the budget consultation and provide 'expertise' on budgets.

At the June 2023 workshops, we sought views on the possible approaches to budget setting, and analysed the responses.

**Option one (code manager sets their budget ahead of year)** received the greatest number of supportive comments, as well as the fewest unsupportive comments. Common themes included suggestions that code managers would be best placed to set their own budgets, but that appropriate industry scrutiny of budgets would be required. In response to the suggestion of including a role for SAFs in scrutinising budgets, we received a far higher number of positive comments than negative.

**Option two (ex-post budget controls)** received a far greater number of unsupportive comments than supportive. Workshop participants pointed to the high resource burden on Ofgem and the potential for excessive focus on budget management at the expense of improving performance.

**Option three (ex-ante budget controls)** received a similar number of supportive and unsupportive comments. Workshop participants noted that this approach would provide a high degree of oversight and could afford increased protection for consumers against excessive costs. Some less supportive comments suggested that this option would also likely involve a

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<sup>31</sup> This would involve code managers setting their own budgets ahead of year, with Ofgem periodically able to disallow costs that, for example, are not economically and efficiently incurred.

<sup>32</sup> This would involve Ofgem deciding on budgets at set periods, e.g. ahead of every budget year.

<sup>33</sup> Please refer to Chapter 8 for more detail.



high resource burden on Ofgem and would be dependent on Ofgem having sufficient expertise to assess costs in advance.

**Option four (budgets agreed by Ofgem at selection)** received a greater number of unsupportive than supportive comments, with workshop participants commenting on the lack of opportunity for direct industry scrutiny of budgets and the lack of flexibility afforded within the budget-period. A further challenge raised to this approach was that it would be dependent on an effective and competitive tender process.

### 3.3 Options and analysis

We further consider each of the four options below.

#### **Option one: code managers set their own budgets ahead of year**

This option broadly aligns with accepted processes employed by a number of existing code bodies which currently undertake some similar functions to those that will be undertaken by code managers under the new framework.<sup>34</sup>

Under this option, code managers would be required to publish their proposed budget, in draft form, for a defined period of consultation. This would allow code parties, SAFs, Ofgem and other interested parties to scrutinise and comment on the draft budget. Once a budget is finalised (following consultation and any amendments made in response to comments received), code managers would be required by the licence to spend in line with that budget. We propose that this approach would be supported by checks and balances to ensure that budgets are cost-reflective, economic and efficient, and subject to appropriate scrutiny. This would include a requirement on the code manager to consult publicly on a draft budget, a role for SAFs in scrutinising budgets, and the power for Ofgem to direct code managers to revisit the budget in certain circumstances. These checks and balances are discussed in further detail below.

#### **Option two: ex-post budget controls**

Under this option, code managers would set a budget and spend in line with it during the relevant period, with costs being recovered from code parties in accordance with the cost recovery methodology. Following the end of the budget period, costs would be reported to Ofgem, who would carry out an assessment of costs and disallow any costs that are not, for example, considered economic and efficiently incurred. This could involve a consultation stage, with Ofgem consulting on a minded-to position before issuing a final determination.

While this approach arguably provides a greater level of scrutiny of expenditure by Ofgem than option one, we consider it to involve a disproportionately high resource-burden on Ofgem given the likely limited scale of code manager budgets. We also consider this option provides less incentive for industry to scrutinise budgets directly compared to option one, and places too great an emphasis on Ofgem to assess costs. Our position is that code managers should be not-for-profit, as well as fully funded through charges levied in accordance with their licence

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<sup>34</sup> For example, RECCo, as code administrator for the Retail Energy Code (REC), is required ahead of each financial year to publish, and invite comments on, a draft strategy setting out its expected costs. Xoserve, as central system delivery body, is required by the Uniform Network Code (UNC) to publish and consult on its budget each year. Similarly, Elexon, in its role as central system delivery body under the Balancing and Settlement Code (BSC), is required to publish and consult on a draft business strategy ahead of finalising its budget.

and the relevant code, so a challenge with this approach is that if costs are disallowed after they have been incurred there may be no source of funding from which to recover those costs.

### **Option three: ex-ante budget controls**

Under an ex-ante budget control process, a proposed budget prepared by the code manager would be presented to Ofgem ahead of the relevant budget period. Ofgem would carry out an assessment of the proposal before consulting on a minded-to position on what budget should be allowed, followed by a final determination on allowed costs. As with option two, this approach provides detailed scrutiny by Ofgem but would involve a high resource burden. For example, as it will likely be challenging to predict costs early in the new governance framework, this option may require Ofgem to consult on and set budgets every year. It may also lack some flexibility. Although we would hope that budgets would not often need to change mid-period, where they do, compared to options one and two, this option would introduce an additional party (Ofgem) into the process for agreeing budgets.

We recognise there is an argument that closer oversight by Ofgem could reduce the risk of higher costs to consumers, and that this could justify the higher resource-burden. We consider option three would place too great an onus on Ofgem to make decisions, with less of an emphasis on industry directly scrutinising, and challenging, the code manager budget. We consider industry to be best placed to scrutinise code manager budgets and that industry scrutiny is the most proportionate, fairest, and most effective, approach to holding code managers to account on their proposed expenditure. This aligns with stakeholder views received at our industry workshops and in response to Ofgem's December 2022 call for input.

### **Option four: budgets agreed by Ofgem at selection**

Under this option, the prospective code manager would propose the revenue it needs, during the code manager selection process, with Ofgem agreeing to this if appropriate. For a fixed-term appointment this could be for the duration of the licence, but it could be challenging to adopt where licences are not granted for a fixed-term. Where licences are enduring,<sup>35</sup> one approach could be to fix budgets at appointment for a given period (with allowance for factors such as growth of the role and inflation), before switching to one of the other approaches set out here for subsequent budget periods.

While setting budgets at selection may work in tandem with the selection process to introduce a degree of competitive pressure to drive down costs (to the extent that code managers are selected through competitive procurement),<sup>36</sup> and would provide certainty on costs, it would lack opportunities for stakeholders to scrutinise budget proposals, which we consider to be a key consideration when deciding which mechanism to employ. Also, given that the code manager role will be new, with uncertain costs associated, it may be difficult for prospective code managers to accurately predict expenditure and for Ofgem to assess whether costs are reasonable. It would also lack the flexibility to adjust budgets within a budget period, should new or unexpected costs arise.

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<sup>35</sup> Please see the section 9.7 'Licence duration' in Chapter 9.

<sup>36</sup> Please see Chapter 9.

## **Rationale for our preferred option one**

We consider option one, code managers setting their budgets ahead of year, to be the most appropriate approach.

### *Stakeholder scrutiny*

Firstly, this approach provides a suitable balance between allowing for budget scrutiny by industry stakeholders and Ofgem and ensuring that controls are not unduly burdensome. While ex-post or ex-ante budget controls potentially provide more rigorous scrutiny of budgets, this comes at the cost of a high resource-burden for Ofgem, which we consider would be disproportionate given the likely scale of code manager budgets.

Option one places a greater emphasis on stakeholder scrutiny than the other options considered, and we consider industry stakeholders to be well-placed to provide appropriate scrutiny of code manager budgets. This is in line with stakeholders' existing role in scrutinising the budgets of some of the code administrators and central system delivery bodies.

### *Transparency of costs*

Under option one, code managers would be required in their licence to present all costs and expenses transparently in published budgets, including those relating to services procured from external providers. This would provide stakeholders with the opportunity to carry out appropriate scrutiny of proposed costs and expenses ahead of the relevant year.

### *Value for money and efficiency*

Our proposal that the code manager role is carried out on a not-for-profit basis (please see Chapter 2 above) will minimise the risk that code managers will be motivated to inflate their budgets, or overstate costs, therefore reducing the need for Ofgem control over code manager budgets. However, we recognise that if code managers are permitted to outsource certain aspects of their role to for-profit providers, those providers may inflate charges to the code manager. To minimise this risk, code managers would be required to set out costs incurred via third parties clearly in their budgets to allow stakeholder scrutiny.

### *Stability and predictability of charges*

Since code managers would be required to consult publicly on their budget ahead of year, this would provide code parties with a forecast of charges for the forthcoming year. Having budgets agreed ahead of the year, with the opportunity for costs to be challenged before being incurred, would minimise the need for reconciliation at the end of the year which could result in unpredictable charges.

### *Flexibility*

Although option one would involve agreeing budgets before the start of the year, we propose that code managers would be able to modify budgets, following consultation with stakeholders, where they anticipate that costs and expenses will be materially different from the budget.

## Further proposals in relation to preferred option one (including proposed licence content)

To provide assurance that code manager budgets are open to appropriate scrutiny and that costs remain economic and efficient, we propose that the checks and balances set out below are included in the code manager licence.

1. A requirement for budgets to be cost-reflective (allowing for contingency to ensure budgets are stable and to cover unexpected events), and for the costs included to be economic and efficient.
2. Code managers would be required to publish, for a set consultation period, a draft budget ahead of the relevant year and invite comments from interested parties, including Citizens Advice and Consumer Scotland. Code managers would be required to take consultation responses into account, and respond appropriately, when finalising their budgets.
3. When publishing draft and final budgets, code managers would be required to set out their costs in a clear and transparent manner. This would include any costs relating to external service providers where these had been procured to carry out aspects of the code manager role.
4. In addition to the requirement on code managers to consult publicly, SAFs would have a defined role in scrutinising budgets. We propose that this would occur in addition to the wider, public, consultation. Code managers would be obliged by the licence to consider scrutiny from the SAF and to respond appropriately to comments.
5. Ofgem would be able to direct code managers to revisit some or all of the budget and require them to take actions including, but not limited to, providing additional evidence or recalculating certain cost categories. This could occur, for example, where SAF or other stakeholder comments have not been sufficiently addressed, or where Ofgem has concerns about the values reported. This could include the ability for Ofgem to require the code manager to provide third-party assurance on the content of some or all of the budget. For example, where Ofgem has concerns about the accuracy of information presented in the budget, they could require the code manager to provide a statement from their auditors. We welcome stakeholder views on how this could be achieved. We do not propose that Ofgem will have the power to veto a budget.
6. The licence will include provision for changes to be made to the budget in-year.<sup>37</sup> This would include a requirement to consult on the changes and to publish an updated budget.<sup>38</sup>

We propose that there will not be an appeal mechanism for budgets included in the code manager licence. We consider that the checks and balances set out above will provide an appropriate level of scrutiny, with a clear role for industry stakeholders, including SAFs, as well as for Ofgem. Introducing a direct appeal to Ofgem risks disincentivising stakeholders from engaging with the code manager using existing budget-setting processes, and potentially delaying issues being resolved. Our view is, therefore, that where stakeholders have concerns about a budget, this should be addressed through engagement with the code manager and

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<sup>37</sup> We recognise that it may not always be possible to accurately forecast costs ahead of year, either because of uncertainty around required expenditure (especially early in the new framework) or due to unexpected costs arising.

<sup>38</sup> This mechanism could involve a shorter consultation period than the annual budget setting process to reduce the risk that code managers are unable to cover their costs in light of unexpected costs.

through the normal budget-setting process, and that the backstop provision of an Ofgem direction (to revisit some or all of the budget) is more efficient than an appeal mechanism.

## 3.4 Consultation questions

Please provide rationale for your answers to the below questions:

- **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?
- **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.
- **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?

## 4. Code Manager Funding and Cost Recovery

The April 2022 government response stated that code managers will recover the costs of carrying out their role through charges levied on code parties. These charges on code parties would be determined in accordance with a methodology set out in the relevant code. We also said that, provided appropriate processes and safeguards were in place, code managers could be allowed to charge code parties and non-code parties (e.g. a prospective code party) for some value added or optional services. The government response also expressed agreement with comments from stakeholders on the importance of the transparency of code manager budgeting, fair distribution of costs and on the necessity for funding to be flexible.

In previous publications, we have referred to the code manager having a charging methodology. In this consultation, we will refer to “code manager cost recovery methodology” instead of “charging methodology”. This is to avoid any confusion with the network charging methodologies set out in the codes. The code manager cost recovery methodologies will only concern charges the code manager issues to recover the costs of its services.

We continue to anticipate the need for two different categories of code manager charges, ‘core’ and ‘optional’ charges. Where there is value in charging per service used, then optional charges can be issued. For example, where a party takes a service purely for its own benefit (e.g. bespoke training) and where a cost signal would help to ensure the party uses the service efficiently, then an optional charge may be warranted. There may be no scenarios in practice where optional charges are necessary, but we believe that it is appropriate at this stage to retain this as an option.

For all other costs the code manager incurs in meeting its duties, it would issue core charges. This would be a recurring charge based on a set formula. This will cover the bulk of the code manager’s operational costs, and we anticipate that most of the code manager charges will be core charges. For the rest of this section, we will focus on core charges. We will further consider optional charges in a future consultation.

### 4.1 Summary of options

We have analysed four options for how code managers could recover their costs through core charges, with option four being our preferred option:

- **Option one: Retain existing code administrator cost recovery mechanisms.** For example, if a code contains a methodology for how the current code administrator must recover its costs, this could be used or repurposed for the incoming code manager.
- **Option two: Ofgem develops a new cost recovery methodology for each code.**
- **Option three: Recover from smallest monopoly cohort that is a party to the code.** By ‘smallest monopoly cohort’, we mean the group of monopolies with the fewest number of licensees. For example, the smallest cohort under the Smart Energy Code (SEC) would be the holder of the Smart Communication Licence, since this is only one licensee.

- **Option four (preferred): Ofgem decides on a code-by-code basis** (between options above).

## 4.2 Stakeholder views

In Ofgem's December 2022 call for input, code manager funding and cost recovery was identified as a priority area for the licence. Respondents largely agreed with this, with some pointing out the importance of the question around how the code manager will be funded.

At the June 2023 workshops, we presented the four options, above, on possible approaches for code managers to recover costs through core charges.<sup>39</sup> We did not ask workshop participants to identify their preferred option, and workshop participants could comment on multiple options. Option four received the most supportive comments, while option three received the most unsupportive comments. Options one and two received more supportive comments than unsupportive.

Responses to **option one** included that retaining existing arrangements could be a resource efficient approach, as well as predictable for code parties. However, a downside could be that arrangements that are not working well are retained, and that it would be a missed opportunity to improve this.

Some responses to **option two** agreed that a benefit of this option could be to create consistency and uniformity across the codes and the code managers, setting minimum standards and clarifying expectations from Ofgem. However, it was also noted that developing new methodologies can be time-consuming and inefficient in comparison to retaining existing approaches.

Responses to **option three** included concerns over potential lack of transparency and engagement. A small number of supportive comments cited simplicity and the potential to facilitate new market entrants. However, it was noted this could be countered by a potential lack of engagement from those not directly paying. Overall, option three received significantly more negative responses than positive.

Responses to **option four** highlighted its flexibility as one of the main benefits, and that being able to both retain existing systems and develop new ones where appropriate is the most sensible approach. The main concern raised with option four was that it could risk retaining inconsistent approaches across the code managers.

Comments made at the workshops raised a number of themes that we have considered ahead of this consultation, namely that charges should be transparent, proportionate, fairly allocated, stable, and predictable.

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<sup>39</sup> These were referred to as 'fixed charges' in the workshops.

## 4.3 Options and analysis

We have further considered each of the four options below.

### **Option one: Retain existing code administrator cost recovery mechanisms**

Where there is an existing cost recovery mechanism to utilise, the benefits of this option include its simplicity and clarity, and that it retains mechanisms that work well. However, suitability will depend on several factors, such as code consolidation<sup>40</sup>, how well the existing systems work, and how the charges would translate to the new code manager role.

### **Option two: Ofgem develops new methodologies**

This would provide opportunity for consistent approaches across codes, providing clarity. However, it could involve unnecessarily changing existing cost recovery mechanisms that work well.

### **Option three: Recover from smallest monopoly cohort**

This approach is simple from an administrative perspective, allowing code managers to recover all their costs from one group of parties. Also, these monopolies have a regulated source of income, which would reduce the risk of gaps in code manager funding. However, a risk with this approach is that it could lack transparency and accountability, as it may not be clear where costs are ultimately recovered from. The monopolies' charging frameworks are tailored to reflect who is using their services, which does not include the code managers, and this could ultimately result in less cost-reflectivity of code manager charges. It could also risk disincentivising parties that are not directly funding the code manager from engaging with the code manager's budget setting process and cost reporting.

### **Option four: Decide on a code-by-code basis**

This approach would allow Ofgem to develop a new code manager cost recovery methodology where appropriate, while allowing well-functioning mechanisms to be maintained. This would be resource efficient and flexible. However, it would also risk retaining inconsistencies between code managers.

### **Rationale for our proposed preferred option**

We consider option four ("decide on a code-by-code basis") to be a proportionate approach that provides flexibility as it allows us to carry out an assessment of current arrangements and decide, case-by-case, which approach should be taken on cost recovery. This option received the most supportive comments in stakeholder workshops, citing its flexibility and proportionality as benefits.

In practice, we propose that Ofgem would decide on a code-by-code basis if the existing cost recovery mechanism should be retained, including (but not limited to) considering whether:

- the incumbent code body is being appointed as code manager

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<sup>40</sup> As proposed in Ofgem's parallel consultation available here: <https://www.ofgem.gov.uk/publications/energy-code-reform-implementation-consultation>



- consolidation with another code is planned
- there is an existing cost recovery methodology and if it is clearly set out; or
- the existing approach is transparent and balances cost-reflectivity with proportionality.

Following this assessment, if it is not believed that the existing system is appropriate for the circumstances of the code, a new methodology could be developed.

## Proposed licence content

While option four would potentially involve different cost recovery approaches across the codes, we do not believe that this would require distinct licence conditions. Instead, we propose that the licence contains high-level requirements including (but not limited to) the four areas set out below (set out across two licence conditions: one regarding the cost recovery methodology and another regarding cost recovery statements). Our proposals only address cost recovery related to 'core' charges. When we further consider the approach to optional charges, it may require changes to our proposed licence drafting, to the extent that optional charges need to be reflected in either the cost recovery methodology or statements.

### **1. Compliance with a cost recovery methodology**

We propose requiring the code manager to comply with a cost recovery methodology set out in the relevant code, except where GEMA ("the Authority")<sup>41</sup> consents otherwise.

This requirement ensures charges to funding parties are in line with a codified methodology, which is transparent and subject to open governance. Enabling Authority consent to the code manager not complying with the methodology will provide some flexibility for extraordinary circumstances.

We note that similar conditions in other licences include charging objectives, against which any proposed modifications to the charging methodology must be assessed. They also include a requirement for the licensees to periodically review the methodology and bring forward any necessary changes to ensure it is fit for purpose and achieves the charging objectives. We have not, at this stage, proposed to include similar arrangements in the code manager licence. We will consider whether we need similar content in relation to the code manager cost recovery methodology in due course.

### **2. Cost recovery statements**

We propose requiring the code manager to prepare and comply with a cost recovery statement that aligns with the cost recovery methodology. This would include outlining that:

1. The cost recovery statement must allow for parties who expect to pay charges to be able to make a reasonable estimate of the amount they will be charged under the cost recovery methodology.
2. The form of the first statement must be approved by the Authority, with further approval required ahead of the code manager making a material change to the form.
3. The code manager must review the statement periodically, at least once each regulatory year, to ensure it continues to be accurate and reliable. It must update the statement once a year (the intention is that this would align with its annual update to its budget). It

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<sup>41</sup> GEMA is the Gas and Electricity Markets Authority.

can update it more than once in a year, for example if there is a mid-year change to the cost recovery methodology and budget, but this is expected to be an exception rather than the norm, as such, we require that they seek Authority consent for mid-year amendments to the statement.

4. The licensee must give the Authority notice for a period of time (sending a copy of that notice to its funding parties) where it intends to make any amendments to the statement such that it would change its core charges (for example, if it changes the unit rates underpinning its core charges). The Authority can consent to exempt the code manager from this step.
5. The statement must be available on the licensee's website, and a copy provided to anyone who requests it.

These requirements will aid transparency and provide a useful tool for parties that expect to pay charges. We believe that requiring the Authority to approve the form of the first statement will ensure that the statement is in a form that ensures parties liable to charges have sufficient clarity and transparency on what these are likely to be. It should be noted that the licence will need to specify when the first cost recovery statement must be made available following the licence being granted. This will need to be aligned with the broader transitional arrangements and the budget setting process, in particular, the first budget. We will consult on the detail of this in due course.

Requiring that code managers give sufficient notice of any changes to, for example, the unit rates that underpin the core charges, will be useful for ensuring transparency of any upcoming changes to charges, as well as giving stakeholders time to scrutinise the proposed changes. However, we believe it is prudent to include an ability for Ofgem to exempt the code manager from providing this notice, which may be necessary where an urgent change to charges is needed to avoid the code manager from getting into financial difficulty.

## 4.4 Consultation questions

Please provide rationale for your answers to the below questions:

- **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?**

**Q4.2: To what extent do you agree with our proposals regarding code managers recovering costs, including that they should be required to comply with a charging methodology set out in the code and that they would be required to produce an annual cost recovery statement to allow for parties who expect to pay charges to be able to make a reasonable estimate of the amount they will be charged?**

- **Q4.3: 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?**

## 5. Code Manager Incentivisation

In carrying out their regulated functions, code managers will receive a guaranteed income stream from code parties. As set out above, we propose that the core regulated business will be undertaken on a not-for-profit basis. Although the absence of a profit motive means code managers will not be incentivised by profit-maximising behaviour, the absence of profit arguably means there could be weaker incentives to perform well and provide value-for-money.

We therefore need to consider how code managers can be incentivised, the role stakeholders should play in assessing their performance, and how they can be held to account for poor performance.

We stated in the government response that we consider it vital that industry stakeholders should play an important role in scrutinising code manager performance. Both the options we present here include a role for stakeholders in setting performance measures and assessing performance. We are seeking views on the approach to incentivising performance, and on our preferred option, as well as the general principles of setting performance measures and the role of stakeholders.

### 5.1 Summary of options

In this section, we present a summary of the two possible overarching approaches to incentivising code managers, and include further details on our preferred option (option one):

- **Option one: no financial incentive mechanism or revenue at risk**
- **Option two: financial incentives with revenue at risk**

We recognise the importance of having in place appropriate tools for addressing poor performance by code managers, and this will be addressed in a future consultation. We will consider, for example, whether to include provisions on minimum performance standards, assessment of which could be informed by reporting against key performance indicators (KPIs). Where poor performance also constitutes a licence breach (for example, if minimum standards are not met), this could allow Ofgem to consider enforcement action in line with Ofgem's published enforcement guidelines.<sup>42</sup>

### 5.2 Stakeholder views

Ofgem's December 2022 call for input stated that incentive mechanisms could include KPIs and/or performance assessment and that there may be a role for Ofgem and stakeholders in overseeing performance and incentives. Ofgem sought views on whether any of the contents identified for inclusion in the licence, including incentives and performance assessment, might be unnecessary or more effectively covered outside the licences.

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<sup>42</sup> The Enforcement Guidelines, Ofgem (March 2023). Available at: <https://www.ofgem.gov.uk/publications/enforcement-guidelines>

Several respondents directly or indirectly addressed code manager performance. These comments included:

- the code manager licence should include an obligation on code managers to deliver high performance
- Ofgem should be able to revoke licences in the case of poor performance
- the licence should include a requirement for code managers to report publicly on their performance
- KPIs/clear performance targets should be in place to ensure good performance; and
- stakeholder advisory forums (SAFs) and/or code parties should have a role in reviewing and assessing code manager performance.

At our June 2023 workshop on code manager incentives, workshop participants were invited to comment and provide views on the two options set out above. Option two (financial incentives with revenue at risk) generated by far the most comments, with a large majority of those expressing concerns about this option. Concerns raised with this option included the potential resource impact on both Ofgem and code managers. Some workshop participants also suggested that financial incentives could lead to a focus on meeting targets at the expense of delivering other aspects of the role and being effective administrators. Others raised concerns about the difficulty of setting incentive mechanisms at the right level to deliver desired outcomes. It was questioned whether financial incentives would be feasible in a not-for-profit model. Several workshop participants suggested that, as long as KPIs are set appropriately, financial incentives could serve to incentivise the right behaviours and to encourage improvements.

Option one (no financial incentive mechanism or revenue at risk) received significantly fewer comments but, of these, more were positive than negative. Comments from workshop participants included that non-financial tools, such as licence obligations which can be enforced where breaches occur, should be used ahead of performance incentives, and that public reporting could provide suitable incentives. One workshop participant suggested that the ability for Ofgem to remove code managers could act as an incentive to perform well, and another stated that the ability to revoke licences will be essential if no financial performance incentives are in place. Some suggested that non-financial incentives are ineffective.

In terms of what behaviours and outputs should be incentivised, common themes included effectively facilitating the implementation of strategic change, good customer experience and facilitating cross-code cooperation.

On how performance should be assessed, there was more support for qualitative performance assessment (such as customer surveys), than for KPIs, with a number of comments questioning the efficacy of KPIs in assessing holistic performance of certain behaviours. Should KPIs be put in place, the majority of comments supported these being set by code managers, in consultation with industry stakeholders, and being set out in the code rather than in the licence.

## 5.3 Options and analysis

In this section, we provide further detail on what these two options would entail and set out why we consider our preferred option (option one) to be the most appropriate approach.

## **Option one: no financial incentive mechanism or revenue at risk**

Under this option, code managers would have their performance measured through, for example, KPIs, customer surveys, or a combination of both, but this would not translate into higher or lower revenues. There would be no performance margin which could increase or decrease in line with performance. This approach would instead be based on reputational incentives. We propose that a set of performance measures would be set out in the code or a subsidiary document to the code. The licence would then require code managers to report publicly and transparently on their performance against these metrics.

We consider that public reporting can be an effective method for incentivising good performance, and our observations are that code administrators are concerned with public and industry perception of their performance.<sup>43</sup> It also carries a lower risk of creating a ‘box-ticking’ culture to performance management whereby code managers concentrate on performance against metrics which are most closely tied to financial rewards.

In a future consultation, we will present additional approaches to addressing poor performance by code managers. We will consider, for example, whether to include provisions on minimum performance standards in the code manager licence, which would allow Ofgem to consider enforcement action. We also intend to consider additional measures such as director removal.

## **Option two: financial incentives with revenue at risk**

Option two is to include financial performance incentives based on ‘revenue at risk’. Under this option, code managers would be able to opt to include revenue at risk, which would be released or withheld depending on the outcome of the performance assessment process. Under our proposed not-for-profit model, this revenue at risk could only be used for permitted purposes, for example, to provide performance bonuses for staff or improved facilities.<sup>44</sup>

This option would not include a requirement on code managers to include revenue at risk, and they would be allowed to choose whether or not to do so.

Release or withholding of revenue at risk would be based on measures of performance such as KPIs, or more qualitative assessments, which might include the use of customer surveys, or a combination of both. As with option one, stakeholders, including Ofgem, would have a role in developing KPIs with the code manager, and the code manager would also be required to publish, in a transparent manner, the outcomes of performance assessments.

## **Rationale for, and further detail on, our proposed preferred option**

We consider option one (no financial incentive mechanism or revenue at risk) to be the most appropriate approach to incentivising a high standard of performance under the proposed not-for-profit model. While we recognise that financial performance incentives arguably create stronger incentives, we consider that public reporting would be an effective and proportionate approach for code managers. This is supported by comments received from stakeholders in our workshops and in response to Ofgem’s December 2022 call for input, as well as our observations that code administrators are concerned with public and industry perception of their performance.

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<sup>43</sup> For example, actions taken by Code Administrators in response to the findings of the Code Administrator’s Survey 2021. Available at: <https://www.ofgem.gov.uk/sites/default/files/2022-01/Code%20Administrator%27s%20Survey%20Report.pdf>

<sup>44</sup> Note that option one does not preclude licensees from including provision for staff bonuses in their budgets.

We consider the inclusion of financial incentives in the form of revenue at risk to involve an increased administrative burden on Ofgem and on code managers, and that this is not balanced by clear benefits. We also consider that including financial incentives risks creating a ‘box-ticking’ culture where code managers target certain metrics to maximise the revenue released, and that this could be at the expense of less clearly measurable outcomes such as facilitating the strategic direction.

## Proposed licence content

We propose that performance incentives will be reputational, without revenue at risk. Under this approach, code managers would be required by the licence to report, publicly and transparently, on their performance against a set of performance measures set out in the relevant code. These measures could include KPIs and more qualitative measures such as customer surveys.

This approach could involve Ofgem incorporating an initial set of performance metrics, covering key aspects of performance such as customer satisfaction, into the relevant code. Alternatively, the code manager could develop the initial set of metrics, through consultation with stakeholders and Ofgem, and then propose a code modification to incorporate the metrics in the code. Regardless of how the initial set of metrics are developed, they could be further modified and added to over time, through the normal code modification process, but code managers would be required to ensure that the performance metrics continued to meet requirements or objectives set out in the licence.

While we do not propose that the licence will specify which performance measures should be included, as the most appropriate measures may vary from code to code, we recognise that there would be benefits to having a degree of consistency across codes on how code manager performance is assessed, as this would enable better benchmarking of performance across code managers.

These proposals do not prevent code managers from including, in their budget, provision for staff bonuses or internal performance incentives. These would be subject to the normal budget scrutiny process set out in Chapter 3 and we would anticipate that any performance bonuses for senior executives would take into account the outcome of public reporting on performance.

## 5.4 Consultation questions

Please provide rationale for your answers to the below questions:

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

## 6. Conflicts of Interest and Independence

Empowered and accountable code management with independent decision-making is a key aim of code governance reform. As the code manager takes on its role, it is important that any potential bias and conflicts of interest are identified and effectively mitigated.

This section sets out our proposals for licence conditions to mitigate conflicts of interest and promote independence and accountability in the code manager. Additionally, we consider that these conditions should be used to inform the assessment of code manager candidates in the selection process, which we expand on below under in Chapter 9.

The key risks of bias and conflicts of interest that we have identified are:

- the code manager unduly preferring itself or an affiliate<sup>45</sup> when prioritising or making decisions and/or recommendations about code modifications, or other decisions outside of the modification process; and
- the code manager could provide advice or services to an affiliate or code party that gives them, or the code manager itself, an undue advantage (noting that it is the remit of a code manager to provide independent and impartial advice to code parties).

These risks could undermine the independence of, and confidence in, the code manager and the new code governance regime as a whole. This could hinder the development of the codes, and in turn have a negative impact on consumers and competition.

When developing our proposals, we have considered the identified risks set out above, stakeholder feedback (described below), and existing gas and electricity licence conditions that are designed to manage conflicts of interest. Our considerations when assessing possible approaches, and in determining our proposal, included whether the approach:

- sufficiently addresses the identified risks, and facilitates an independent and unbiased code manager; and
- is proportionate, considering the strategic importance and role of the code manager.

### 6.1 Overview of proposed approach

We propose that the following requirements be incorporated as standard licence conditions in the code manager licence, with two areas where we are seeking views on possible additional prescription:

- prohibition on engaging in preferential or discriminatory behaviour
- not prevent nor distort competition
- sufficiently independent directors
- possible additional prescription: restrictions on directors' affiliations (with possibility of exceptions)

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<sup>45</sup> This means in relation to any person, any Holding Company of that person, any Subsidiary of that person, or any Subsidiary of a Holding Company of that person.

- restriction on activity and investments (with possibility of exceptions)
- restriction on the licensee becoming a related undertaking (with possibility of exceptions)
- ultimate controller undertaking; and
- possible additional prescription: business separation requirements.

## 6.2 Stakeholder views

Ofgem's December 2022 call for input proposed conflicts of interest as a priority area for the development of code manager licence content. Respondents broadly agreed, with a number pointing out the importance of managing conflicts of interest in the code manager licence, including that code modifications are managed and prioritised fairly.

At our May 2023 workshops, many workshop participants had concerns over conflicts of interest, particularly in connection with the code manager's ability to make code changes that influence its business, performance, and revenue generation, as well as the code manager's ownership and source of funding. There was strong support among workshop participants that the code manager licence could be an effective tool for mitigating these concerns.

## 6.3 Rationale for proposed approach

We believe that the proposed licence conditions, set out below, comprehensively address the risks of code manager conflicts of interests by preventing preferential treatment and undue influence from code parties and other affiliates. We recognise that these conditions may necessitate some potential candidates establishing new internal governance arrangements or setting up ringfenced SPVs in order to undertake the role.

To maintain some flexibility, we are proposing routes for the Authority to make exceptions to the licence conditions related to restrictions on activity and investments, and restrictions on the licensee becoming a related undertaking. This may be appropriate in scenarios where, for example, the Authority considers there is a benefit in maintaining existing code body arrangements, and that this does not cause unacceptable risk. If we were to proceed with adding additional prescription in the licence on directors' affiliations, whereby all directors would be restricted from being affiliated with code parties (explained below), we consider Authority exceptions may also be required here, to avoid unintended consequences.

We consider that the proposed approach is proportionate and appropriate to the risk of conflicts of interests arising, given the central role of code managers in code governance and their ability to impact the change process.

Below we set out further detail on the proposed conditions, and their intended effects. The proposed licence drafting can be found in Annex A. We have drawn on existing licences when drafting the detail of the conditions.



## 6.4 Proposed approach – analysis and recommendation

### Prohibition on engaging in preferential or discriminatory behaviour

To address the risk that the code manager could unduly prefer itself, an affiliate, or a particular code party or group of parties, this licence condition would prohibit preferential or discriminatory behaviour by the code manager when performing its licensed activities.

### Requirement to not prevent nor distort competition

This licence condition would require the code manager not to prevent or distort competition in activities under, or connected to, relevant energy licences<sup>46</sup> when conducting its licensed activities. This would further address the risk of preferential treatment towards itself and affiliates.

### Sufficiently independent directors

We propose requiring the code manager to have independent representation on its board. “Independence” would be defined as independent from the code manager, its affiliates, any external service providers (i.e. a party contracted by the code manager to support it in delivering its duties) and from parties of the relevant code. In particular, the code manager must not have been employed by, been a director of, or held investments (over a certain threshold) in relevant companies during, at least, the past 12 months.

We believe requiring independent representation on the code manager board is an important tool in ensuring that a broad range of perspectives, especially ones that are not influenced by the interests of the code manager, affiliates or code parties, are considered throughout the code managers’ decision-making processes. This will in turn contribute to the code manager acting impartially. Therefore, we expect to require a minimum of two, or 20% of, directors (whichever is greater) to meet the independence requirements specified above. However, we may decide that a larger proportion of the board should be independent (e.g. 50%) as we continue to develop broader board composition requirements and further policy on how decisions under the code will be made.

### Possible additional prescription: restrictions on directors’ affiliations

We have considered extending the director independence requirements further, with the possibility of placing restrictions on all (executive and non-executive) directors in respect of their affiliations. This licence condition, if implemented, would prevent all code manager directors from having investments in, being employed by or being a director of a code party or, if applicable, an external service provider.<sup>47</sup> As noted above, we believe it would be necessary to include the ability for the Authority to approve exceptions, for example to enable existing arrangements to remain where these are beneficial and do not create unacceptable risk.

Our initial view is that, while this licence condition may further ensure code manager impartiality, the requirement for a minimum number or proportion of independent directors (as specified above) may already sufficiently address the risks, without being overly restrictive regarding board composition in the licence. We note that it is possible for the code manager to

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<sup>46</sup> I.e., for licensed activities related to that code.

<sup>47</sup> These restrictions are similar to those proposed under the ‘sufficiently independent directors’ condition, but it stops short of requiring that directors are independent from the code manager.

go further than the minimum independence requirement, but that prescribing a more restrictive approach could potentially have a negative impact on securing valuable industry experience and expertise on the board.

An alternative approach could be to include a principles-based condition that targets specific concerns around director affiliations, allowing the code manager board some flexibility in how this is achieved. This could, for example, state that the code manager must ensure, and be able to demonstrate, that all directors are sufficiently impartial, but without specifying what restrictions need to be implemented.

We are seeking views on whether restrictions should be placed on director affiliations and, if so, whether the requirement should be prescriptive, or principles based. **We have not included draft licence provisions for this in Annex A.** We will consider responses alongside any broader potential proposals we bring forward on board composition.

### Restriction on activity and investments

This licence condition would prevent the code manager from conducting any activities or having any investments apart from what is required to fulfil their duties under the licence or a relevant code. We consider this to be important for ensuring that the code manager is focused on its licensed role, and that it does not invest or take on activities that could undermine its independence.

However, we recognise that this could potentially be too restrictive in some cases, and that potential candidates for the code manager role may have pre-existing roles and businesses, which Ofgem does not consider poses an unmanageable conflict of interest. Where Ofgem considers that such a candidate is well-suited to the role of a code manager, it may be possible for the candidate to become compliant by separating the part of the business that becomes licensed (for example, by creating an SPV). As a separation might not always be feasible or desirable, we propose that there are also routes for the Authority to make exceptions to this licence condition. These exceptions may similarly be of use where a code manager is in place, and it is decided that they would be well-placed to take on an additional role beyond code management. These exceptions could be listed in the licence condition itself, be granted through Authority approval, or be permitted through provisions in the code. It should be noted that this would only be used where Ofgem is confident it would not lead to an unacceptable conflict of interest.

### Restriction on the licensee becoming a related undertaking

This condition would prevent the code manager from being or becoming a related undertaking<sup>48</sup> of a code party or an external service provider (i.e. a party contracted by the code manager to support it in delivering its duties). This condition would also prevent the code manager from being, or becoming, a related undertaking of any person with the ability to exert material influence over a code party or external service provider, such as a subsidiary of the code manager's parent company. This would include a route for exceptions through Authority approval, permitted exceptions in the licence conditions, and/or setting out exceptions in the relevant code.

This requirement would ensure that no code party, or, if applicable, external service provider, or a person with material influence over these entities, has significant control or influence over

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<sup>48</sup> Related undertaking means, in relation to any person, any undertaking in which that person has a participating interest as defined in section 421A of the Financial Services and Markets Act 2000.

the code manager, which could impact its impartiality (e.g. when making decisions that impact either code parties or external service providers). An additional consideration is where a subsidiary of the code manager's parent company is contracted by the code manager to provide services. If such an entity is contracted to provide services by the code manager, revenue could flow back to the parent company or wider group, introducing potential conflicts of interest.

However, we recognise that there may be instances where Ofgem considers that a code manager being a related undertaking of a code party does not constitute an undue risk for conflicts of interest. Therefore, we believe a route for exceptions is required, to avoid unintended consequences.<sup>49</sup>

### Ultimate controller undertaking

This licence condition would require the code manager to obtain a legally enforceable undertaking from any ultimate controller (e.g. parent company), where applicable, stating that they will not undertake any action that might cause the licensee to breach its licence or fail to discharge any of its functions.

This aligns with licence conditions in the smart meter communication licence as well as gas and electricity network licences. It would mitigate the risk of an ultimate controller impacting the code manager's ability to conduct its licensed duties.

### Possible additional prescription: business separation requirements

We have considered further requirements on business separation, which we are seeking stakeholder input on. This licence condition would introduce further prescription on the separation between the code manager and an affiliate (for example a parent company), including restricting access to offices and IT-systems, ensuring staff, accounts, audits, reports and information management are kept sufficiently separate.

These measures could provide further reassurance in addressing the risks and concerns around discrimination and preferential treatment by the code manager by being more prescriptive about what a separation must entail, in comparison to the licence conditions proposed in the section above. However, it may be disproportionately restrictive and resource-intensive for the code manager role, should they be not-for-profit. We invite respondents' input on incorporating this licence condition, in particular if stakeholders identify any particular circumstances where this would be particularly beneficial. **We have not provided draft licence provisions in the Annex for this possible licence condition.**

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<sup>49</sup> In due course we will consider what licence revocation provisions are needed, including any in relation to change of control of the licensee.

## 6.5 Consultation questions

Please provide rationale for your answers to the below questions:

- **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?
- **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?
- **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
- **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?

## 7. Financial and Operational Controls

Code managers will be funded through charges levied on code parties in accordance with the licence and relevant code. We propose elsewhere in this consultation that the regulated activity of code management will be carried out on a not-for-profit basis. The risk of a company carrying out the code manager role becoming insolvent will, therefore, likely be small. However, it would be disruptive if a company carrying out the role were to become insolvent or be otherwise unable to carry out its role due to financial difficulty or insufficient operational capability.

We propose that the code manager licence will include a suite of standard licence conditions intended to address risks associated with the financial stability and operational capability of code managers. On the basis that not-for-profit also entails that the code manager is 'not-for-loss', these conditions will protect (or align with code provisions that protect) code parties in their exposure to financial risk under their funding obligations to the code manager in the code. We have considered whether the proposed licence conditions are proportionate to the risk and impact of financial failure, and stakeholder views will help inform our position on this.

When assessing appropriate controls to include in the code manager licence, we have considered the standard licence conditions in other licences across the energy sector, including the smart meter communication, electricity transmission, electricity distribution and gas transporter licences. We recognise that the code manager role differs in financial scale compared to other licensed activities, but we consider that it is nonetheless appropriate to include controls and requirements designed to ensure that code managers remain financially stable, can carry out their licensed activities and that code parties are protected from exposure to financial risk. Should an entity carrying out the code manager role suffer financial failure, this would necessitate selection of a new code manager, which would be disruptive.

### 7.1 Summary of proposals

Our proposed approach is to include the following standard licence conditions in the code manager licence:

- availability of all necessary resources
- indebtedness and transfers of funds
- assurance on the financial stability of the licensee
- prohibition on cross-subsidy; and
- restriction on making profit.

## 7.2 Proposed licence conditions – analysis and recommendations

### Availability of all necessary resources

The April 2022 government response stated that code managers will need to have the right expertise and resources in place to fulfil their roles and responsibilities successfully. We consider it prudent to include a requirement for the code manager to ensure that it has available (either directly or under appropriate contractual arrangements) all appropriate resources and operational capability to carry out the code manager role, and that it will act in a manner designed to ensure that it continues to have those resources available. This will also support the code manager selection process, as we propose that Ofgem will consider a persons' ability to meet the requirements under the licence at the selection stage (as explained further in Chapter 9).

We propose that this condition would include a general requirement on the code manager to act in a manner designed to ensure that it has available the appropriate resources and operational capability to enable it to properly, and efficiently, carry out the code manager role. 'Appropriate resources' includes financial resources, management resources, personnel, fixed and moveable assets, rights, licences, and facilities. This should occur primarily by means of effective budgeting processes (see Chapter 3) and this condition would support the requirement to carry out the budgeting process effectively.

We consider that it may also be appropriate to require the code manager to provide a form of assurance that the appropriate resources are in place and that it has the operational capability to carry out the role. In line with similar licence conditions for other types of licensee,<sup>50</sup> we propose that code managers would be required, each year, to provide to Ofgem with a certificate of adequacy, approved by the code manager's board of directors, stating that they have in place the appropriate resources to enable them to carry on the code manager business for the following 12 months, taking into account charges on code parties. For consistency, the form of certificate could be specified in annexes to the relevant licence condition (see Annex A). Code managers would also be required by the licence to inform Ofgem immediately if they become aware of any circumstance where the board no longer believe they will have in place the appropriate resources to carry out the role. In the first instance, we would expect code managers to amend budgets in-year to account for unforeseen costs, as set out in Chapter 3. However, we consider it prudent to include a requirement for code managers to notify Ofgem where this may not be sufficient to address potential issues.

### Indebtedness and transfers of funds

We propose that the licence conditions should place restrictions on the code manager's ability to incur debt or have exposure to the financial risks that are not associated with the licensed business, including those of other persons who are affiliate or related undertakings. This is to ensure that any liabilities the code manager may assume (which are in turn funded by code parties) will only be liabilities relating to its undertaking of the licensed code manager role. This

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<sup>50</sup> For example, the smart meter communication Licence requires licensees to provide certificates stating that they have sufficient financial and operational resources in place. Gas and Electricity Supply licences also require licensees to provide 'certificates of adequacy' in which they declare compliance financial responsibility requirements.

would protect code parties from financial exposure to the code manager undertaking activities outside its licensed role.

We propose that this would include a prohibition on entering into indebtedness, guarantees or obligations, except in accordance with certain requirements. These requirements are that the transaction in question must be on an arm's length basis, on normal commercial terms, and must be for the purposes of carrying out the licensed code manager role.

Code managers would also be prohibited from transferring, leasing, licensing or lending any sum, asset, right or benefit to any affiliate or related undertaking, except in defined circumstances, including where payments are on an arm's length basis and on normal commercial terms.

## Assurance of the financial stability of the licensee

We propose two possible approaches to addressing financial stability of the code manager, and we welcome stakeholder views on how this could be best achieved. We have included both approaches in the draft licence in Annex A.

The less prescriptive approach is to include in the licence a requirement to have in place suitable financial controls, but to not require the code manager to provide specific assurance on financial stability (such as reporting against financial KPIs). This approach would provide assurance that the code manager has appropriate controls in place, and the condition above (availability of all necessary resources) would provide assurance that they have sufficient financial resources available.

A more prescriptive approach could be to require the code manager to provide specific assurance on financial stability. This could involve a requirement on code managers to report on their financial stability to code parties and/or the SAF, or to Ofgem. There may be a range of corporate models for the companies carrying out the code manager role, and this may necessitate different approaches to providing assurance. To allow flexibility, this could involve a requirement on code managers to propose to Ofgem or code parties arrangements for providing assurance as to their continuing financial stability (e.g. agreeing to report against financial KPIs and/or providing evidence of internal financial controls). This would not require the licence to specify the form of assurance to be provided, but would instead allow code managers to agree with Ofgem and/or the SAF the appropriate arrangements. This is similar to the current approach taken to obtaining assurance on financial stability in the smart meter communication licence.

## Prohibition on cross-subsidies

This condition would prevent the code manager from receiving, or transferring, cross-subsidy from or to a parent company or affiliate. The primary risk addressed by this condition is that the code manager could inflate charges on code parties in order to cross-subsidise other activities undertaken by them or by other companies in the group. We propose to incorporate this condition into the code manager licence to mitigate these risks.

## 7.3 Consultation questions

Please provide rationale for your answers to the below questions:

- **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?
- **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?



## 8. Code Maintenance and Modification

### 8.1 Code ownership

#### Background and context

The gas and electricity industry codes were created, and are maintained, in accordance with conditions contained in relevant licences. We refer to these licence conditions here as the ‘code owner’ conditions. The code owner conditions are not identical across the existing licence types, but the conditions generally include, among other things, the scope of the code, specified code content, how the code can be modified and the applicable code objectives.<sup>51</sup>

The Energy Act 2023 (the ‘Act’) introduces licensed code managers, who will be responsible for the governance of designated codes. We have therefore considered whether the code owner conditions, and associated licence requirements (insofar as they remain relevant), should be removed from the existing licences, and included instead in the code manager licence.

#### Stakeholder views

Ofgem’s December 2022 Call for Input asked respondents for their views on whether there are any issues, such as unintended consequences, that should be taken into account when considering moving the current code owner licence obligations to the incoming code manager.

Respondents did not identify any blockers to including the code owner licence conditions in the code manager licence or removing the existing provisions from current licences. Some respondents commented that existing code owners would need to retain an appropriate level of influence over a code where activities are defined by reference to legislation, for example where codes impact the safe and reliable operation of the networks. Other stakeholders commented that the timing of this would need to align with code consolidation and code manager appointment and that there may be consequential impacts on other licence conditions that would need to be considered.

#### Proposed licence content

We propose including a standard licence condition that requires code managers to have in place and maintain the relevant code. The code manager will be responsible for the governance of the code and therefore we consider that it is appropriate their licence includes the code owner obligations. This will require code managers to, among other things, modify the code in prescribed circumstances. It would also include obligations to have in place specified modification arrangements and other core code content.

This proposal would require consequential changes to the existing code owner licence conditions, whereby these provisions would be removed from the existing licence types. Ofgem will consult on any consequential licence modifications in due course, using transitional powers in the Act that are provided to Ofgem to implement energy code reform. Ofgem will consider if other consequential changes are needed to existing licences to ensure that current code owners continue to play an appropriate role in the modification process. This would include

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<sup>51</sup> For example, electricity transmission standard condition C10 (Connection and Use of System Code).

reviewing obligations on network owners related to charging methodologies contained in the codes.

## 8.2 Other obligations

In light of the changes introduced by the Act, and our reforms more broadly, we have also considered, and outlined below, other licence obligations related to the maintenance and modification of the code that we consider should be included in the code manager licence. The following is not exhaustive, and we will consult on the full licence content in due course.

### Stakeholder Advisory Forum (SAF)

In our earlier consultations, we set out our expectation that code managers would be required to establish SAFs and to consult with them ahead of making certain decisions. Ofgem's consultation on the implementation of energy code reform includes proposals on how SAFs could be constituted, including Ofgem's preferred option<sup>52</sup>. To ensure that SAFs are created and maintained by the code manager, we propose to include an obligation in the licence to have a SAF in place and to include key elements of its role. The detailed role of SAF in the modification process will be developed in future work by Ofgem and included in the industry codes.

### Consumer Advocates

In the April 2022 government response, we said we would expect groups that represent the consumer voice to be members of relevant SAFs. This remains our view and we propose to include this requirement (similar to existing arrangements in respect of panels)<sup>53</sup> in the code manager licence.

We recognise that arrangements across codes are not fully consistent in terms of the role of consumer advocates. Part of Ofgem's work in developing a modification process will be to consider how to ensure consumer advocates can best engage in this process. We are also considering ways to ensure that code managers are appropriately surfacing and analysing the consumer perspective and will consult on any related licence provisions in a future consultation.

### Direct code changes

Section 192 of the Act provides Ofgem with the power to modify designated codes directly under defined circumstances. In using this power, Ofgem must follow a process set out in the Act. This includes publishing a notice about a proposed modification and considering any representations made in response to the notice. Should Ofgem decide to make the modification, it must publish a notice about this decision setting out, amongst other things, the decision to make the modification and the date from which the modification has effect.<sup>54</sup>

We propose to include an obligation in the code manager licence, requiring them to amend the published version of the relevant code in line with any notice by Ofgem under the Act section 193(5) modifying the code. Ofgem will implement any changes required to accommodate its

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<sup>52</sup> [Energy code reform: implementation consultation | Ofgem](#), section 5.

<sup>53</sup> In respect of Citizens Advice and Consumer Scotland.

<sup>54</sup> Section 193(6) of the Energy Act 2023.

new direct code change powers as part of its work to develop and implement change to the existing code modification processes and procedures.<sup>55</sup>

## 8.3 Consultation questions

Please provide rationale for your answers to the below questions:

- **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?
- **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?

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<sup>55</sup> [Energy code reform: implementation consultation | Ofgem](#), section 5.

## 9. Code Manager Selection

Under the new system for energy code governance, code managers will be selected and licensed by Ofgem. These bodies will be directly accountable to Ofgem under the terms of their licence and will take on roles currently performed by code panels<sup>56</sup> and code administrators, including the making of recommendations, and in some cases decisions, on code modifications. They will also be responsible for playing an enhanced role in the code change process, by ensuring that the codes develop in line with an annual Strategic Direction Statement that will be prepared and published by Ofgem<sup>57</sup>.

This decision-making role will require a code manager that is sufficiently resourced, independent, and accountable. We have set out above proposed licence conditions to ensure that this is achieved. It is also critical that Ofgem is empowered to select the best candidates for the code manager role, while being particularly mindful of the risks posed by potential conflicts of interest.

The Energy Act 2023 (the ‘Act’) includes provision for the selection and licensing of code managers by the Gas and Electricity Markets Authority (GEMA).<sup>58</sup> Section 187(1) of the Act empowers GEMA to select code managers via one of two mechanisms: a non-competitive process, in accordance with any regulations made under Section 188 by the Secretary of State; or a competitive process, in accordance with any regulations made under Section 189 by GEMA.<sup>59</sup> Regulations could include, for example, the related processes, conditions, and/or restrictions that GEMA would be required to apply, or consider, when making various determinations related to code manager selection.

This chapter sets out our proposals for the design of the code manager selection regulations and associated processes, including decision-making criteria and candidate assessment. The overall objective of these proposals is to establish a code manager selection regime that can deliver the following outcomes:

- considers the candidate’s ability to meet the requirements of the role and enables Ofgem to identify a viable candidate, in a way that ensures a positive outcome for both industry and consumers
- accords sufficient flexibility to Ofgem in its decision-making, including how to select code managers and who to select, without establishing unnecessary process constraints or restrictions; and
- is underpinned by the principles of objectivity and transparency, including the publication of clear and objective criteria prior to running a selection process and ensuring appropriate consultation with stakeholders.

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<sup>56</sup> Throughout the document, the term “industry panels” is used to refer to the existing industry-led governing bodies for in-scope codes (including panels, governing committees and change boards).

<sup>57</sup> Section 190 of the Energy Act 2023.

<sup>58</sup> The Gas and Electricity Markets Authority is the governing body of Ofgem. It consists of non-executive and executive members, and a non-executive chair, that are appointed by the Secretary of State at the Department for Energy Security and Net Zero. In this chapter, we refer to ‘GEMA’ when referencing specific sections of the Act and to Ofgem otherwise, but the two terms can largely be viewed as being interchangeable in this context.

<sup>59</sup> In this section, the term “regulation(s)” is used to refer to secondary legislation made in the form of a Statutory Instrument.

## 9.1 Stakeholder views

After considering stakeholder feedback, we set out a decision in the 2022 government response<sup>60</sup> not to make competitive tender the default selection option for code managers and not to require Ofgem to seek permission from the Secretary of State to pursue a selection option other than a tender. This decision was intended to ensure that Ofgem would have the flexibility to choose from both competitive and non-competitive selection options for a given code, subject to any constraints established by the Secretary of State via secondary legislation. It also reflected concerns expressed by some stakeholders regarding the potential viability of a code manager market, without which it would be difficult to justify the added time and expense of running a competitive process.

We further engaged with stakeholders in May 2023, by hosting two workshops exploring the code manager selection regime. We asked questions related to the types of characteristics that might affect a code manager's ability to do its role, the kinds of expertise that might be required, and what Ofgem should consider when deciding how to select a code manager.

Stakeholders suggested that existing code experience and energy sector knowledge will be crucial factors for a successful code manager. Other factors mentioned included the importance of code managers being able to adapt to the new requirements of the role, such as the ability to deliver on strategic priorities, innovate, and take steps to support the achievement of net zero.

Many workshop participants had concerns over conflicts of interest, as described further in Chapter 6 above, particularly in connection with the code manager's ability to make changes that influence its business, performance, or revenue generation, and its ownership and source of funding. We discussed different ways to mitigate potential risks, with strong support among workshop participants for the proposal that the code manager licence could be an effective tool in this regard.

When discussing the scenarios in which Ofgem might license code managers via different selection methods, it was suggested by many attendees that directly selecting current code bodies could be a preferred route for code manager selection where the existing code administrator is performing well. Competitive selection was favoured in scenarios where more than one potentially suitable body might exist, and stakeholders recognised that a new Special Purpose Vehicle (SPV) might be suitable where code consolidation outcomes mean that no existing body has the required expertise or experience for the role.<sup>61</sup>

## 9.2 What does the Act say about code manager selection?

A full list of relevant provisions can be found in section 187-189 of the Act, as summarised in Table 3 below.

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<sup>60</sup> [Government response to the consultation on Energy Code Reform \(publishing.service.gov.uk\)](https://publishing.service.gov.uk)

<sup>61</sup> An overview of Ofgem's recent proposals on code consolidation can be found in the following consultation: <https://www.ofgem.gov.uk/publications/energy-code-reform-implementation-consultation>

**Table 3: Summary of code manager selection provisions in the Act**

Section of the Act	Explanation
Section 187(1)	Empowers GEMA to determine whether to select code managers via a competitive or non-competitive process, in accordance with any regulations made under Section 188 or Section 189.
Section 187(2)	Empowers the Secretary of State (SoS) to make regulations to inform how GEMA determines whether to proceed with competitive or non-competitive selection, as well as to establish the circumstances in which GEMA may switch between those two options. The regulations may also include criteria to be applied by GEMA when making its determinations.
Section 187(3)	Empowers the SoS to establish requirements in regulations that must be met by a person for them to be selected as code manager, as well to specify who may or may not be selected.
Section 188	Empowers the SoS to make regulations about the selection of a code manager by GEMA on a non-competitive basis. These regulations may also be used to enable GEMA to appoint an entity that it has created to serve as code manager. If made, these regulations must make provision to address potential conflicts of interest.
Section 189	Empowers GEMA to make regulations about the selection of a code manager by GEMA on a competitive basis. If made, these regulations must make provision to address potential conflicts of interest.

### 9.3 Code manager eligibility

Our view is that the integrity of the code manager’s decision-making process will rely on its ability to operate with autonomy, free from any prejudicial influence from commercial interests. The proposed code manager licence conditions (see above) aim to address risks of potential code manager conflicts of interest. In addition, we have considered how the code manager selection regulations and associated processes could be designed to address conflict of interest risk and whether certain eligibility requirements should be met for a person to qualify for selection as a code manager.

This section contains proposals in connection with Section 187(3) of the Act pertaining to the eligibility of bodies to take on the code manager role.

#### Proposals

We have identified several potentially high-risk characteristics arising from the corporate structures or affiliations of companies acting as code managers, which could increase the risk of conflicts of interest occurring, namely:

- where the code managers have a profit motive for themselves and/or their related companies, or where a body may make profit through a subsidiary appointed as a code manager

- where the code manager is controlled by, or controls, a code party; and
- where the code manager provides an advisory role on a commercial basis to code parties.

We have considered the most appropriate instrument in which these characteristics should be addressed, including the potential inclusion of certain characteristics in regulations to prevent bodies with associated conflicts of interest from being eligible for selection. However, we do not believe that adding this level of detail into regulations is necessary. Instead, we are content for the regulations to provide for an assessment by Ofgem at selection of a body's ability to meet the code manager licence conditions designated by the Secretary of State.

Accordingly, the Department proposes to specify in regulations that Ofgem must assess conflict of interest as part of its selection process. Where Ofgem is not satisfied that a conflict-of-interest risk is manageable, or the prospective code manager is unwilling to implement appropriate mitigations, then the regulations would serve to prevent a code manager licence from being granted to that body. Where a potential conflict exists, but Ofgem is satisfied that the conflict may be manageable, the regulations would enable Ofgem to require the entity to demonstrate that it can satisfy the relevant licence conditions by implementing mitigations.

The Department's preferred approach is not to pursue additional measures in these regulations, such as excluding persons of a particular description from selection or establishing eligibility criteria. Our view is that any risks associated with candidate eligibility can be dealt with sufficiently via the conflict-of-interest provisions proposed in the previous paragraph, in combination with Ofgem's assessment of each candidate's eligibility and ability to comply with relevant licence conditions.

We welcome stakeholder feedback on our proposal not to place additional restrictions or eligibility criteria in regulations on who can be selected as a code manager, aside from a mandatory assessment of conflict of interest.

## 9.4 Ofgem's choice of selection route

This section contains proposals in connection with Section 187(2) of the Act pertaining to how Ofgem may decide whether to select a code manager on a competitive or non-competitive basis.

We believe that regulations made under Section 187(2) of the Act should ensure that Ofgem is able to choose a selection route that is effective and efficient in delivering benefits for industry and consumers, in line with the overall aims of code reform. Therefore, the Department proposes to specify in regulations that Ofgem may use its discretion over whether to select a code manager on a competitive or non-competitive basis. We propose that decisions on selection route will be based on the considerations set out below. We do not, however, consider that it is necessary to place any criteria in regulations. In addition, the Department is also proposing to provide Ofgem with the flexibility to switch from one selection route to the other, where Ofgem deems this is warranted.

When determining how to select a code manager under Section 187(1) of the Act, we propose that Ofgem applies the following two considerations.

## Speed of delivery

We expect that different selection approaches will have different implementation timelines, which means that Ofgem's choice of selection route may have the potential to either expedite or prolong the implementation of code reform. For example, the non-competitive selection of an existing entity is expected to be the fastest option, whereas more time is likely to be needed if Ofgem decides to run a competitive process or establish a new special purpose vehicle (SPV) to serve as code manager. We believe that getting a code manager in place as quickly as possible will generally be in the best interests of both industry and consumers. Ofgem therefore proposes to consider the following factors when determining its choice of selection route:

- the time needed to undertake the selection process;
- whether an existing entity, such as an incumbent code administrator or other closely related code body, may possess sufficient experience and expertise to meet the relevant eligibility criteria; and
- whether the code in question has been consolidated and may therefore have more than one potentially eligible incumbent code administrator or code body to consider.

## Value for money

We recognise that participation in any selection process, whether competitive or non-competitive, will place resource demands on interested parties. However, we expect that the demands associated with a competitive process are likely to be higher than those associated with the direct selection of an existing entity, with the extra costs potentially being borne by either industry or consumers (e.g. where an existing code body, who is funded by industry participants, chooses to take part). These higher costs may be justified in some cases, such as if they would be expected to generate cost efficiencies as the result of competitive pressure or would enable multiple interested parties to compete for the position. But we believe that keeping process costs low – where the outcomes of the process would likely be the same or similar – would be in the best interests of industry and consumers.

Ofgem therefore proposes to consider the following factors when determining its choice of selection route:

- whether there is likely to be sufficient interest to justify a competitive process, particularly considering our proposal to require code managers to operate on a not-for-profit basis
- whether there is likely to be sufficient value in running a competitive process, in terms of both efficiency of process and effectiveness of outcome; and
- whether competitive pressure is likely to be available through an alternative mechanism, such as by allowing code managers to sub-contract various non-critical functions.

## Preference for non-competitive selection

We anticipate that the above considerations – alongside our proposal to make code management a not-for-profit activity – would lead Ofgem to prefer non-competitive selection in many cases. For example, where an existing body has already been established for the purposes of administering a code, assessing that candidate's eligibility via the direct selection route first would likely provide the greatest benefits for consumers, in terms of both speed of



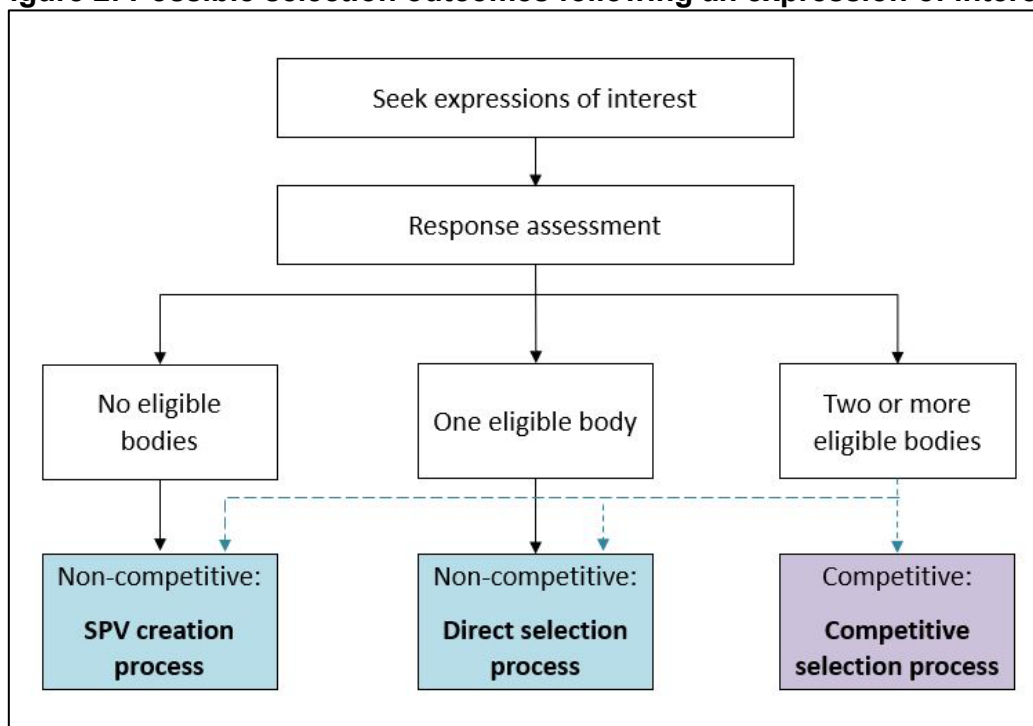
delivery and value for money. If Ofgem determined not to directly select that body following this assessment process, Ofgem would then have the option of either pursuing a competitive approach or creating an SPV.

#### *Indicative process outcomes*

Where a code **has not** been consolidated, Ofgem would first consider the incumbent code administrator or code body via the non-competitive selection process. In addition to the benefits that this approach would offer in terms of speed and value, it would also have the added benefit of minimising any potential disruption to ongoing business. As outlined below, however, the selection of an incumbent body would not be a foregone conclusion. All code manager candidates would be subject to Ofgem's conflict of interest assessment and would be required to demonstrate their ability to meet relevant eligibility criteria, in line with the licensing framework set out above. The applicant would also need to demonstrate a sufficient degree of readiness to take on what will be a new and expanded role, which may require changes to current organisational cultures or ways of working.

Where a code **has** been consolidated, Ofgem would engage with incumbent code administrators and codes bodies to determine whether one or more of them are likely to have sufficient interest, expertise, and experience to manage the new code. If this is unlikely to be the case, or if Ofgem identifies that more than one candidate may be eligible, then Ofgem would consider either creating a new SPV (which could potentially involve merging elements of existing bodies via transfer schemes or collaborative initiatives) or running a selection competition.

In instances where Ofgem may require further information prior to determining its choice of selection route, the Department proposes to enable Ofgem to seek expressions of interest from prospective code managers via regulations. This would enable Ofgem to evaluate the relative merits of pursuing a competitive versus non-competitive selection process by identifying how many eligible candidates are interested in the role. As shown in Figure 2, a determination that no eligible candidates exist would likely lead to the creation of an SPV; one eligible candidate would likely lead to a direct selection process; and two or more eligible candidates could potentially lead to all three possible outcomes, either a direct selection process, a competitive process or the creation of a new SPV.

**Figure 2: Possible selection outcomes following an expression of interest**

It is also worth reiterating that the Department is proposing to design the regulations in a way that would enable Ofgem to switch between selection routes if needed. This means that Ofgem could start down the non-competitive selection route and then switch to competitive selection, or vice versa, as explained in the indicative scenarios above.

We welcome stakeholder feedback on our proposals in this section, including the proposal for Ofgem to consider speed of delivery and value for money when deciding how to select code managers, and the indicative preference for non-competitive selection where beneficial. We also welcome stakeholder feedback on the proposal not to include criteria relating to these considerations in regulations.

## 9.5 Non-competitive selection process

This section contains proposals in connection with Section 188 of the Act pertaining to the process of selecting a code manager in a non-competitive manner. The Department proposes for these regulations to provide the following:

- a. **selection of an existing entity following a non-competitive process:** we propose to enable Ofgem to select an existing code body directly, if it deems that body to be a viable candidate to take on the role of code manager following a non-competitive assessment process;
- b. **mandatory assessment of conflicts of interest:** as part of this process, Ofgem would be required to determine whether the candidate has any unmanageable conflicts of interest. If they do, then Ofgem would not be able to grant a licence to that entity (as explained above in the section on candidate eligibility); and
- c. **licensing of an SPV formed by GEMA:** we are also proposing for the legislation to expressly include provision for Ofgem to form and license a Special Purpose Vehicle (SPV) specifically for the code manager role.

Where an existing entity has been identified as a potential code manager, Ofgem proposes to assess that candidate against the following three criteria:

- **ability to comply with standard licence conditions** of the code manager licence, including those related to conflict of interest and the operation of the core regulated business on a not-for-profit basis (see Chapter 2 and 6 for our proposals on these conditions);
- **availability of resources** to fulfil the obligations of the role, including proposed arrangements for commencing the licensable activity, such as the availability of, or plans to acquire, any necessary skills or expertise (including the hiring of staff or the development of plans to outsource certain activities);<sup>62</sup> and
- **suitability to hold a licence** (e.g. a ‘fit and proper’ assessment), including disclosing past criminal convictions and bankruptcies in line with Ofgem’s existing requirements for gas and electricity licence applicants.<sup>63</sup>

As well as potentially selecting an existing candidate through this process, Ofgem may also decide to create and license a new SPV. In practice, such a body may be formed by industry actors for this purpose, either at the direction of, or in collaboration with, Ofgem. Examples of similar decisions include the recent establishment of the Retail Energy Code Company (RECCo) by Ofgem and the Smart Energy Code Company (SECCo) by Government. These bodies were then transferred to industry ownership.

Where Ofgem decides to license a new SPV, either by creating the company itself or in collaboration with industry, the set-up arrangements would be designed in line with both the policy objectives of code reform and the code manager standard licence conditions. The candidate assessment criteria outlined above would therefore be replicated in the SPV design principles.

We propose that Ofgem would consult with stakeholders when it has reached a minded-to decision to grant a code manager licence under the non-competitive process, to enable stakeholders to make representations. Responses to these consultations would then be considered prior to deciding whether to grant the code manager licence.

We welcome stakeholder feedback on our proposals in this section, in terms of the process and criteria that Ofgem proposes to follow when appointing a code manager on a non-competitive basis.

## 9.6 Competitive selection process

Section 189 of the Act stipulates that GEMA has the power to make regulations relating to the competitive selection of a code manager. Ofgem proposes to consider different approaches to competitive selection, recognising that competition between not-for-profit candidates may not

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<sup>62</sup> Ofgem may also use the power granted to it by the Act to transfer property, rights, or liabilities from relevant bodies to the incoming code manager, where they are required by the code manager to fulfil its licence obligations. Where they are required, their use would be undertaken in consultation with the affected parties. Their use could also lead to the payment of compensation or measures to protect staff pensions, in line with our obligations set out in Schedules 12 and 13 of the Act.

<sup>63</sup> See here for an example of what this kind of suitability assessment could entail: [The Electricity \(Applications for Licences, Modifications of an Area and Extensions and Restrictions of Licences\) Regulations 2019 \(legislation.gov.uk\)](#) and [The Gas \(Applications for Licences and Extensions and Restrictions of Licences\) Regulations 2019 \(legislation.gov.uk\)](#)

be well suited to a full tender process. Ofgem will consult on competitive regulations in due course, following consideration of the responses to this consultation and responses to Ofgem's recent consultation on its approach to implementation and transition, which included proposals on code consolidation.<sup>64</sup>

## 9.7 Licence duration

Ofgem recognises that there are merits and risks to granting code manager licences on a time-limited versus enduring basis. Where an entity is directly selected to be code manager or a new SPV has been created to take on the role, an enduring licence could provide certainty and stability for both the body and stakeholders, as well as provide for long-term strategy. It is common for Ofgem to grant licences on an enduring basis, with the possibility of revocation in circumstances specified in the licence. Alternatively, as the number of code manager licences will be limited to the number of codes, licences could be granted for a fixed term, with licence reviews at certain intervals and a further selection process to award a new licence (either competitive or non-competitive) in future. This might enable, for example, a review of the potential for competition in the market for code managers, once the code manager role has been fully established.

We are inviting stakeholder views on code manager licence durations, in particular the circumstances in which a time-limited licence may be preferable (for example, whether the approach should vary depending on Ofgem's chosen selection route)

## 9.8 Consultation questions

Please provide rationale for your answers to the below questions:

- **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?**
- **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?**
- **Q9.3: To what extent do you agree with the proposed process and criteria for appointing a code manager on a non-competitive basis?**
- **Q9.4: Do you have any views on whether code manager licences should be granted on an enduring versus time-limited basis?**

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<sup>64</sup> Energy code reform: implementation consultation, Ofgem (January 2024). Available at: <https://www.ofgem.gov.uk/publications/energy-code-reform-implementation-consultation>

## 10. Next Steps

The responses received as part of this consultation will be used as additional evidence to inform future policy decisions on energy code reform.

Following the publication of this consultation we intend to host a webinar summarising our key proposals, in both this and the Ofgem consultation on the approach to implementing the reforms.<sup>65</sup> Please see the consultation's page on GOV.UK for full details<sup>66</sup>. If you would like to register your interest in attending, please email Ofgem's Code Governance Reform team at [industrycodes@ofgem.gov.uk](mailto:industrycodes@ofgem.gov.uk).

A government response, including a summary of the responses received, will be published after the close of this consultation.

A full set of draft licence conditions, and associated policy proposals, will be consulted on in due course. We will also consider policy options for updating the process for appeals to the Competition and Markets Authority (CMA) on Ofgem's code modification decisions, as set out in Statutory Instrument 2014 No. 1293 The Electricity and Gas Appeals (Designation and Exclusion) Order 2014.<sup>67</sup>

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<sup>65</sup> Energy code reform: implementation consultation, Ofgem (January 2024). Available at: <https://www.ofgem.gov.uk/publications/energy-code-reform-implementation-consultation>

<sup>66</sup> Energy Code Reform consultation GOV.UK page: <https://www.gov.uk/government/consultations/energy-code-reform-code-manager-licensing-and-secondary-legislation>

<sup>67</sup> The Electricity and Gas Appeals (Designation and Exclusion) Order 2014 (June 2014). Available at: [http://www.legislation.gov.uk/ukSI/2014/1293/pdfs/ukSI\\_20141293\\_en.pdf](http://www.legislation.gov.uk/ukSI/2014/1293/pdfs/ukSI_20141293_en.pdf)

# 11. Consultation Questions

The full set of consultation questions in this document are below.

## 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?

## 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?

**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?

## 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?
- **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.
- **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?

## 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?

**Q4.2:** To what extent do you agree with our proposals regarding code managers recovering costs, including that they should be required to comply with a charging methodology set out in the code and that they would be required to produce an annual

**cost recovery statement to allow for parties who expect to pay charges to be able to make a reasonable estimate of the amount they will be charged?**

- **Q4.3: 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?**

## 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?**
- **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?**
- **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?**

## 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?**
- **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?**
- **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**
- **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?**

## 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?
- **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?

## 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?
- **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?

## 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?
- **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?
- **Q9.3:** To what extent do you agree with the proposed process and criteria for appointing a code manager on a non-competitive basis?
- **Q9.4:** Do you have any views on whether code manager licences should be granted on an enduring versus time-limited basis?



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This consultation is available from: [www.gov.uk/government/consultations/energy-code-reform-code-manager-licensing-and-secondary-legislation](https://www.gov.uk/government/consultations/energy-code-reform-code-manager-licensing-and-secondary-legislation)

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