

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

Citizens Advice response



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advice**

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Executive Summary

Citizens Advice welcomes a great deal of the proposals in this code manager licencing consultation. In particular we welcome the proposal that code managers would be required to operate on a not for profit basis which we agree is appropriate for the role they will play. We also agree on the level of prescription being pursued and, where proposed, favour additional prescription as this better supports the aim for consistency.

We believe the checks and balances on budget setting and on performance will be critical to getting this right and ensuring code managers deliver in the interests of consumers.

We welcome the acknowledgment of the role of statutory consumer advocates in these processes

More detail is needed on the granularity of budgets, on sub-contracting, and on how stakeholders and Ofgem can be assured of an appropriate link between performance and any rewards, in the absence of a framework for financial incentives.

We think there should be a formal budget appeal route unless there is strong evidence to justify moving away from this approach.

We recommend that the policies and principles proposed for code managers should also apply to central service delivery bodies who are also designated within code reform powers. We believe this would provide greater confidence to industry of the new codes arrangements

We would like to see a requirement for the boards of code managers to follow best practice on independence and believe a consumer champion at board level is important.

We urge Ofgem to ensure that the non-competitive code manager selection process is as robust as it would be under a competitive regime.

Code Manager Licence

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

We support the high level content for licence conditions. In future consultations we are keen to see specific licence conditions related to consumer interests.

For example under *'Nature and conduct of the Licensee's business'* or *'Governance, including stakeholder engagement and cooperation'* we believe there should be clear licence conditions regarding the code manager acting overall in the interests of consumers which should extend beyond just the code modification process and into the operations of the code manager. We also believe these conditions should require code managers to proactively prevent barriers to engagement from those representing consumers.

Under *'Obligations towards Ofgem and the Department'* it is noted that requirements to provide information to Ofgem and the Department may be included. We would also like to see explicit references to the relevant powers granted to statutory consumer advocates in the Energy Act on requesting information and subsequent obligations on code managers.

Not-for-profit Requirement

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

We agree that, overall, the benefits of code managers operating its core business on a not for profit basis outweigh the costs. It will prevent potential risks of trading off profit-maximising incentives with the importance of facilitating effective codes to meet net zero.

Not for profit code managers should best enable effective and transparent discussions in budget setting and performance monitoring. A speedier, more open and transparent budget setting process will prevent resources being spent by industry, and ultimately consumers, on more protracted and contentious processes.

We do not envisage code manager roles as demanding significant and ongoing innovation where commercial parties could be potentially more appropriate, again indicating that not for profit will be beneficial.

We agree that not for profit requirements may limit the pool of potential entities who could take part in a code manager selection process but we think the benefits noted above outweigh this risk.

We support the use of some sub-contracting to commercial parties where necessary or where it brings clear benefits. We also agree with setting limitations on this. In particular we believe licence conditions should prevent commercial parties from creating not for profit entities and then sub-contracting work to themselves where these contracts may be less visible to industry and the Stakeholder Advisory Forum (SAF). Similar independence and separation should be required from central system delivery bodies as code managers could be influential in contracting decisions.

Our anticipation is that continuity and consistency will be required to meet the aims of code reform. In our view this would likely mean longer term contracts and, overall, is highly unlikely to foster a competitive market for potential code managers, again making not for profit a better choice.

Setting Code Manager Budgets

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

We agree with the code manager budget setting approach. In particular we believe it is proportionate where code managers are not for profit bodies, and given the expected scale of code manager budgets.

We agree that other options would result in disproportionate levels of resources being assigned to budget scrutiny by Ofgem and may not add any significant additional value over and above what could be achieved with industry scrutiny.

We agree with the requirement for costs to be presented transparently in budgets. This information should be suitably granular to enable effective scrutiny. To ensure there is consistency in the information provided in budgets,

we recommend Ofgem considers the use of budget/business plan information rules as have recently been introduced by UNC0841¹. This ensures there is clarity both on the responsibilities of the code manager but also the expectations of those providing scrutiny.

Government and Ofgem should consider that third parties who provide services to code managers (assuming this is permitted) may wish budget information to be confidential so there needs to be clarity about the obligations code managers face and in procurement terms to ensure there is transparency of this information and to prevent disputes about confidentiality.

We agree that providing flexibility by allowing changes to be made to budgets in-year is beneficial, however our expectation is that its use should be an exception and not a common occurrence. Such flexibility should prevent any situations arising where budgets are challenged by stakeholders and potentially Ofgem but cannot be suitably resolved in time for the start of the financial year, which risks issues going unaddressed. Flexibility would enable a budget to be implemented and any areas outstanding to be addressed at a later date.

Given the intentions set out here by Government and Ofgem for appropriate checks and balances on code manager budgets, we recommend that the same principles are implemented for central service delivery bodies as well. Ofgem's transitional powers and the designation of these bodies under code reform provides an ideal opportunity to improve arrangements and ensure principles are consistent between code managers and central service providers where they provide similarly crucial roles in an effective and efficient energy system. At present long and protracted code modification changes have had to be made in some instances to improve budget setting processes². Establishing the same principles for central services from the outset of this process would be significantly more efficient and provide greater levels of protections and consistency.

¹ [UNC0841 - Introduction of cost efficiency and transparency requirements for the CDSP Budget](#)

² [UNC0841 - Introduction of cost efficiency and transparency requirements for the CDSP Budget](#)

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.

We welcome our inclusion as an explicit party to be consulted with on draft budgets. To aid engagement we would expect budgets to be written in plain language and with clear explanations and justifications.

We also agree with the consultation with the SAF, however, we are mindful that depending on the size and constitution of the SAF there could be significant overlap between a public consultation and SAF membership which may lead to parties favouring one process over another.

We do not agree that the inclusion of a direct appeal to Ofgem would risk disincentivising stakeholders from engaging in the other proposed budget setting processes, particularly as this is how the process works currently for some central systems delivery bodies. To the contrary, we believe there is greater risk of stakeholders disengaging if they do not feel that their input and feedback is being given due regard and addressed by code managers, particularly if they do not feel they have proper recourse to address this.

We recommend that an effective formal appeals mechanism is introduced to appeal code manager budgets. They are an important recourse for consumers to ensure budgets are appropriate. We consider the formal appeal route currently in place for central service delivery bodies to be best practice and we believe there needs to be strong evidence to move away from this arrangement for code managers.

Crucially a significant benefit of a formal appeals mechanism is clarity in the process which industry and stakeholders can have confidence in. By removing an appeal mechanism the process leading up to Ofgem choosing to use its proposed powers³ is much less clear.

For example, under the proposal (without an appeals mechanism) there could be an expectation by industry that Ofgem are closely involved in budget processes including monitoring draft budgets, consultation responses, and discussions in the SAF in order to be aware of issues and proactively use its

³ "to direct code managers to revise budgets (partly or wholly) and require further evidence and justification to be provided where necessary"

powers when deemed necessary. On the other hand Ofgem could play a more reactive and less resource-intensive role and rely on outreach and feedback from SAF or industry parties before deciding whether to take action. In either case the lack of clarity and the potential for inconsistency will erode confidence in the process for recourse compared to a formal appeals route.

We think there are benefits to having a clear appeal mechanism, even under a not for profit model. Unless there is clear evidence to move away from this we believe it represents a better solution for consumers. An alternative would still require an equivalent process which must be set out in similar levels of detail. This would need to set out the extent to which Ofgem would be proactive or be reactive to industry or SAF feedback and the steps Ofgem would take to decide whether to use its powers. In our view a formal appeals route is a simpler solution as it already exists.

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?

We are concerned that the timeline for budgets is unachievable. The licence provides only 28 days in which industry and stakeholders, including Citizens Advice, can provide feedback on draft budgets. As 6 code managers will be seeking the same feedback at the same time we do not believe this timeline is realistic to allow adequate time for meaningful engagement and feedback. We would also note that unless SAFs are expected to hold multiple meetings per month or hold extraordinary meetings for the purpose of budget setting, the 28 days may only allow for a single meeting of the SAF in which the budget could be discussed which we do not think would be enough.

We are also concerned that code managers will only, in reality, have around 3 weeks in which to reflect changes in their budgets from feedback due to the need to publish a revised budget on the 1st January which is always a bank holiday.

While we understand the licence sets "not later than" milestones and code managers have the option to undertake these processes earlier to provide all parties with more time, we think the licence should reflect an appropriate timeline in the first place.

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?

Yes we agree. This approach is the most proportionate and the most appropriate, particularly where code reform will involve some codes being consolidated while others will not be. It allows arrangements which work well to be carried over and enables faster transitions to code managers, while enabling changes to be made if and where they are most needed.

We recognise that this may result in inconsistencies between code manager cost recovery methodologies, however we do not see this as an area where consistency is particularly necessary or beneficial and instead reflects the differing nature of the sectors and code parties.

We would, however, expect some consistency in the principle of which parties' costs are recovered from. We would anticipate that as a minimum it is logical for industry parties who are expected to provide budget scrutiny to have a 'stake in the game' and therefore be funding parties.

This is not currently the case in some codes. For example under UNC, shippers do not face charges for the code administrator but are nevertheless a significant party of the codes, members of the panel, and users of code administrator services.

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?

We agree with the need to ensure there is a codified cost recovery methodology. As this would be subject to open governance we assume this would require Authority direction as there may be a conflict of interest if a code manager could amend their own cost recovery methodology under a self governance process (or equivalent). If Authority direction were to apply then it will be important that

all codes have appropriate charging objectives. Authority direction would also be consistent with the proposals for Authority approval for cost recovery statements.

We agree that code managers should produce annual cost recovery statements to give clarity to funders of upcoming charges. Ofgem should also consider whether there is benefit in statements providing indicative views of likely charges in subsequent years as a way of providing some visibility, particularly where there might be larger costs recovered over multiple years.

Code Manager Incentivisation

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

We largely agree with the preference to not have financial performance incentives.

In our view the two options presented have significant similarities in reality. Assuming that code managers would have some kind of performance-related rewards anyway, which the consultation indicates would be allowed under option 1, the main difference between the two options is the extent to which the regime is internal to the code manager (option 1) or is external to the code manager (option 2).

Under option 1 there should still be high levels of transparency from code managers to provide assurance that rewards are commensurate with performance. We believe code managers should set out their approach to bonuses in their budget consultation alongside the associated costs to enable stakeholder input and scrutiny up front. This would ensure there is a clear framework for how annual performance informs any rewards made within the code manager, rather than this not being visible to stakeholders.

Under option 2, if a code manager opted for revenue at risk, then the link between performance and rewards would be established transparently under code as a separate exercise from budget setting. In this circumstance code managers, stakeholders and Ofgem would likely be involved in setting these

arrangements. Under this regime there could be greater transparency of the link between performance and revenue.

While we believe option 2 may deliver greater transparency, overall we agree that option 1 is preferred. We agree that this minimises the risk of performance being too narrowly focussed on meeting specific metrics which may struggle to capture the outcomes needed from code managers.

Under option 1 we believe it will be necessary to implement checks and balances to ensure that performance-related rewards, which are budgeted for in advance, are appropriate to the performance of the code manager. This would minimise the risks of rewards not being appropriately linked to performance.

This may require some form of justification in annual or end of year reports of the performance-related rewards delivered relative to performance. While we agree with the consultation that we, too, would *“anticipate that any performance bonuses for senior executives would take into account the outcome of public reporting on performance”*, we believe ensuring there is a process that provides oversight of this is preferable. This information would also allow more rounded scrutiny of subsequent budgets.

We agree that under Option 1 it is right that Ofgem looks at enforcement actions such as director or senior management removal or the ability to intervene in any senior management financial performance rewards.

We agree that reputational incentives should be a mix of quantitative KPIs and qualitative measures, such as customer surveys, to ensure that performance can be measured in a range of ways. We believe reputational incentives can be effective. However, they rely to a great extent on the ease with which performance can be compared between similar organisations. We therefore recommend that code managers are required in their licences to align, as far as practicable, their performance incentives to enable cross comparisons. This could be part of a wider licence obligation for code managers to collaborate effectively with each other. It is important that this performance information is also presented in a single place, as Ofgem does with energy supplier performance.

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?

We recognise the need for KPIs to be modified to respond to future changes and potentially to improve alignment between code managers. However, this does present a risk that code managers diverge in their reporting over time, preventing comparability. It is not clear whether such changes would be required to be implemented by Authority direction and if new guidance or objectives would be needed. Authority direction would ensure code managers cannot make these decisions themselves under a self governance (or equivalent) process where there would be a clear conflict of interest.

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?

Given the importance to effective code management and the aims of code reform, the independence of the code manager is an essential foundation. We agree with the proposed licence conditions to ensure conflicts of interest are prevented or managed. However, we also think there are areas for improvement or clarification.

The term 'external service provider' is used throughout but is described as meaning "*a party contracted by the code manager to support it in delivering its duties*". We take this to mean services sub-contracted by the code manager. We believe it is important that this term is extended to include service providers whose role is closely associated with the code manager's operation of code processes. At a minimum this needs to extend to cover central services bodies and parties like the Allocation of Unidentified Gas Expert (AUGE) in UNC. We think it would be inappropriate for conflicts of interest to arise between code managers and such bodies. Code managers would most likely remain closely involved in contracting committees and modification proposals whose decisions can have material commercial impacts for these businesses.

We agree with requiring sufficiently independent directors and agree with setting a minimum proportion of representation by independent directors. Ofgem should consider what is best practice in this area. Some sources suggest that 50%⁴ or a majority⁵ of independent directors to be best practice.

As we have suggested previously, we believe that code managers should have a form of consumer duty in their licence conditions. This would encourage their actions and decisions to be in the interests of consumers who, ultimately, fund industry governance and codes and should reasonably expect the operation of codes to serve their interests. A not for profit model, on its own, will not necessarily guarantee this. To embed consumer interest into code managers and be held account for this internally we believe licence conditions should also require a Consumer Duty board member as exists under the FCA's Consumer Duty⁶.

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

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

We would welcome prescription on restricting directors' affiliations. With the effort to drive independence of code managers, it is counter productive to have directors overseeing the code manager who have financial interests in a code party or a party employed by the code manager. If Ofgem implements higher requirements for the proportion of independent directors then this requirement would appear a natural extension. We would prefer this requirement to be prescriptive rather than principles based given the importance of overall independence of the code manager.

We agree that a business separation requirement should be introduced to the licence. As Ofgem is proposing to provide for a number of exceptions to licence conditions such as on '*activity and investments*' and on '*becoming a related undertaking*', we believe that separation requirements would be beneficial by mitigating some risks where exceptions have been applied by Ofgem.

⁴ Institute of Directors, [Governance Explainer - director independence](#)

⁵ Deloitte, [The Effective Not-for-Profit Board - A value-driving force](#)

⁶ FCA, [Consumer duty - information for firms](#)

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

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

We understand that it may be beneficial in some limited circumstances for Ofgem to retain the option to apply exemptions where conflict of interest risks are suitably low. However, as we have noted above, we believe a business separation requirement would provide an added mitigation in circumstances where exemptions have been applied. We would welcome examples from Ofgem of the types of circumstances it believes exemptions may be needed to deal with. As we address in response to Q9.1 Ofgem should also be clear about whether these exemptions would also apply in selection eligibility criteria.

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?

We would like to seek clarity on the following drafting *"a sufficiently independent director must not during, at least, the past 12 months before their appointment as a director of the Licensee, have held a position that could be deemed to cause an unacceptable conflict of interest in their role as a sufficiently independent director"*.

We expect this should mean that a person employed by a **current** code administrator could not be a director for the **new** code manager and code which would have entirely new licences and titles. However, we would question whether some further clarity in the licence drafting would be beneficial to ensure it is clear that this is the intention of how it should apply during the transition to code managers.

Financial and Operational Controls

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

We fully agree that for a stable, effective and efficient code manager, it is appropriate to require code managers to have the appropriate resources and capability to undertake the role, and regularly assure Ofgem and stakeholders that this remains the case as new and changing demands become apparent. We agree that a consistent form of certificate of this assurance seems proportionate in addition to budget setting processes.

We also agree with putting in place conditions to ensure that Ofgem is notified where a code manager is at risk of breaching this licence condition given the importance of ongoing code manager operation.

We support the drive for consistency between code managers where possible so prefer the more prescriptive approach described for assuring financial stability of the licensee. Within this, however, we are unclear about what clear benefits are delivered by providing each code manager flexibility to propose different ways of achieving this. In our view the benefit of a prescriptive approach is providing consistency and enabling Ofgem and stakeholders to make comparisons where necessary. The use of KPIs and other evidence seems appropriate to achieve this.

We strongly agree with the requirement on prohibiting cross-subsidies. We would anticipate that the conflict of interest conditions should prevent this occurring anyway, but we support the condition as a further line of defence against this risk.

Code Maintenance and Modification

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

We agree that with the introduction of code managers it is logical that their licence includes code owner obligations. We agree that while removing this obligation from other licenced parties, some others will need to be retained, particularly for network owners and system operators. While it is unlikely that these parties would stop playing an appropriate role in code modification processes under code managers, including some conditions to prevent this may ensure consistency and provide further assurance.

Although Ofgem has not asked for views on other obligations that will be consulted on in future we wanted to offer the following views:

We agree that obligations relating to SAFs will be necessary to ensure the SAFs have a suitable footing within the licence. We also agree that ensuring Authority-directed code changes are implemented by code managers is essential.

We particularly welcome Ofgem's recognition of the valuable role of statutory consumer advocates in codes. We agree that code managers should have obligations for surfacing and analysing the consumer perspective of modifications and ensuring the consumer impact is clearly identified. This brings twin benefits of reducing barriers to engagement as well as demonstrating that the code manager itself is taking responsibility to proactively progress code changes in a way that delivers positive outcomes in the interests of energy consumers.

We look forward to engaging with Ofgem further about the optimal way processes are shaped so consumer advocates can best engage in them.

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?

We are satisfied that if licence conditions are suitably exhaustive then they would act as suitable criteria for selection eligibility. It is not clear whether conditions in regulation would provide any significant additional benefit.

We question whether it is Ofgem's intention that licence condition exemptions could also be permitted during a selection process. Particularly under a competitive process, we believe Ofgem should be clear if the use of exemptions would be a differentiator between competing parties.

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?

We agree that choosing a selection route based on speed of delivery and value for money is appropriate. However, while we agree that keeping process costs down is important, we think that these comparatively small up front costs of running a competitive process should be viewed in the context of code managers potentially being appointed on an enduring basis, where these costs will be a fraction of enduring costs.

We welcome flexibility in how Ofgem chooses which selection route to take, including the ability to make changes to the selection route if necessary.

As there may not be significant numbers of potential candidates for code managers we agree with the preference for non-competitive selection under the circumstances described.

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

We agree with the proposed process primarily because of its speed of delivery. However, it is essential the process is as robust as would be expected under a competitive process with high levels of transparency.

We think that Ofgem should exercise its ability to seek expressions of interest under all of the indicative processes (consolidated and not consolidated) to ensure there has been an opportunity to understand if there are any other potential candidates. We do not view this as adding significant extra time to the process but do believe it provides a better evidence base for taking decisions on the selection route.

We agree that the assessment criteria should apply equally under the direct appointment process or where a new special purpose vehicle (SPV) is created.

One area we believe Ofgem should clarify is whether it would assess a candidate's ability to comply with *all* standard licence conditions and therefore be able to justify an appointment with evidence according to each licence condition. Alternatively does Ofgem anticipate the use of discretion and the potential for trade-offs between licence conditions? We have particular concerns under the direct appointment route where there is a risk that speed of transition could be prioritised over high levels of assurance and evidence for all licence conditions.

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

We see merits under both approaches. Enduring licences would provide greater certainty to prospective code manager candidates and could ensure consistency. However, under this approach industry, Ofgem and stakeholders need to have high confidence in the processes to address underperformance or compliance with licence conditions. This may be challenging under a new regime.

Time limited licences should aim to provide reasonable stability as well and so we do not think it would be appropriate for these to be short, for example less than 5 years.

We see benefits in there being an explicit review point under time limited licences, allowing Ofgem to review performance and consider whether the potential market of candidates has materially changed. While in practice it's possible that nothing would change we do believe that a time limited licence could provide a useful additional incentive to code managers, over and above any other financial or reputational incentives.

Time limited licences may also be useful in allowing the new arrangements to settle in, and provide confidence to all parties involved that the new code manager regime and, crucially, the checks and balances are working effectively before potentially moving to an enduring regime.

We would suggest that any use of time limited licences should have staggered end dates (as with code manager appointment) to ensure that they do not coincide and become unmanageable.

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