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# DESNZ & Ofgem consult on code manager licences

## Headline assessment

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Consultation dates:	11/03/24 – 05/05/24
Impact classification:	Medium: All market participants
Action if desired:	Respond to the consultation

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13 March 2024

# 1. Assessment and recommendation

On 11 March, the Department of Energy Security and Net Zero (DESNZ) and Ofgem issued a joint [consultation on code manager licensing](#) and accompanying secondary legislation. The consultation sets out DESNZ and Ofgem's priority policy points to be included in the new code manager licence, as well as detailing Ofgem's selection process for the assignment and licensing of code managers.

We recommend that any interested market participants respond to the consultation, in order to inform and help refine the proposals from DESNZ and Ofgem and to ensure they are fit for purpose and will work to meet DESNZ's aims for code reform. Responses are requested by 5 May 2024.

*Cornwall Insight comment: This consultation looks to progress energy code reform towards a more efficient and cohesive code design and implementation system. It is important to note that at this stage of consultation, the proposals suggested by DESNZ and Ofgem do require further refinement as by their own words these are high-level contents. The areas of budgeting, code manager funding and code manager incentivisation could be of particular interest.*

## 2. Background

The [Energy Act 2023](#), which achieved Royal Assent in October last year, introduced responsibilities to Ofgem that make it responsible for the implementation of reforming the energy industry codes. The work on energy code reform has been ongoing for several years now, with both government and Ofgem [consulting on the matter in 2019](#) to discuss initial options. Further consultations set out potential design and delivery options for reform in more detail, and in [April 2022](#) government confirmed the move to licenced code managers, replacing code administrators and code panels, who will be responsible for developing delivery plans to facilitate strategic code direction. Stakeholders will also have to engage with the code change process through advisory forums. Now, DESNZ and Ofgem are collaboratively looking ahead to develop the secondary legislation and regulatory framework for code managers.

This consultation sets out that the framework must be forward-looking, able to accommodate the growing number of market participants, and to be responsive to change where necessary. Discussed below are the key policy proposals from DESNZ and Ofgem, including priority areas to be covered by the licences. Below also outlines the proposals for secondary legislation that will underpin Ofgem's code manager selection processes. It should be noted that Ofgem's [consultation on code reform \(consolidation\) implementation](#), which was published on 30 January, is also still open with responses requested by 23 April 2024 (see [Alert 01/02/24](#)).

## 3. Proposals

### 3.1. Policy proposals for the code manager licence

There are seven key policy points that DESNZ and Ofgem are consulting on to be covered by the new code manager licence. Alongside the consultation, DESNZ published in full the [proposed Standard Licence Conditions](#) (SLCs) that would be used to form the new code manager licence. These are summarised below.

#### 3.1.1. Not-for-profit requirement

The consultation proposes a requirement on code managers to operate on a not-for-profit basis. This would be implemented through the proposed code manager budget and charging requirements, which would allow only for recovery of costs without a profit margin. This would be supported further by a restriction on profit in the proposed financial and operational controls section of the code manager licence, as discussed below.

DESNZ noted that while 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 any of the related licence conditions. It considers this will ensure the code manager will prioritise the best outcomes for consumers rather than maximising profits.

### 3.1.2. Setting code manager budgets

For the process of setting the code manager budget, four potential options had been discussed previously, including:

- The code manager sets their own budget ahead of year.
- Ex-post budget controls in place.
- Ex-ante budget controls in place.
- Budgets agreed by Ofgem at selection.

DESNZ considers option one, whereby code managers setting their budgets ahead of year, to be the most appropriate approach. This means code managers would be required to publish their proposed budget and undergo a period of consultation, allowing parties including Ofgem to scrutinise and comment on the draft budget. Within the licence, DESNZ proposes this be outlined more granularly, noting the need for a defined period of consultation, that the budgets be cost-reflective, and is currently proposing no appeal mechanism.

### 3.1.3. Code manager funding and cost recovery

Under this section, DESNZ again discusses four potential options for code management funding and cost recovery mechanisms.

- Retain existing code administrator cost recovery mechanisms.
- Ofgem develops a new cost recovery methodology for each code - this would provide opportunity for consistent approaches across codes.
- Recover from smallest monopoly cohort that is a party to the code. DESNZ clarifies that by 'smallest monopoly cohort', it means the group of monopolies with the fewest number of licensees.
- Ofgem decides on a code-by-code basis (between options above).

The preferred option at this stage is the fourth option, meaning Ofgem would assign any of the remaining three options differently to whatever may be the most appropriate option for each of the new codes, enabling an element of flexibility.

### 3.1.4. Code manager incentivisation

DESNZ noted there was previous debate around introducing a financial incentive for the performance of the code managers. However, the current preferred option is to not introduce one, again emphasising the not-for-profit model. Instead, DESNZ proposes that a set of performance measures should be set out in the code, with licence conditions then requiring code managers to report publicly and transparently on their performance against these measures.

### 3.1.5. Conflicts of interest and independence

DESNZ listed a number of SLC requirements that should be introduced for code managers to address potential areas for conflicts of interest. These include:

- A prohibition on engaging in preferential or discriminatory behaviour.
- Neither preventing nor distorting competition.
- Having sufficiently independent directors.

- Restricting directors' affiliations (with possibility of exceptions and additional prescription)
- Restricting activity and investments (with possibility of exceptions)
- Restricting the licensee from becoming a related undertaking (with possibility of exceptions)
- Ultimate controller undertaking.
- Business separation requirements (with possible additional prescription).

DESNZ considers that the proposed SLCs in relation to these key areas will comprehensively address the risks of code manager conflicts of interests by preventing preferential treatment and undue influence from code parties and other affiliates. It recognised that these conditions may necessitate some potential candidates establishing new internal governance arrangements or setting up ringfenced Special Purpose Vehicle (SPV) in order to undertake the role.

### 3.1.6. Financial and operational controls

As code managers will be funded through charges levied on code parties in accordance with the licence and relevant code, DESNZ considers it unlikely that any will face a high risk of insolvency. Nonetheless, this area of the licence would 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 code parties in their exposure to financial risk under their funding obligations.

DESNZ is proposing the following SLCs: 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.

### 3.1.7. Code maintenance and modification

DESNZ is proposing that under this area of the licence, it will include an SLC requiring code managers to have in place and maintain the relevant code. This proposal would require consequential changes to the existing code owner licence conditions, whereby these provisions would be removed from the existing licence types.

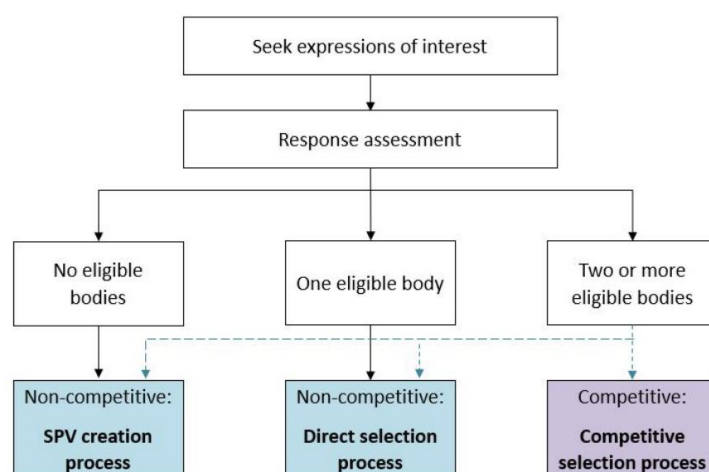
## 3.2. Ofgem's selection process

The consultation also outlines how Ofgem may undergo its selection process for code managers, as it will be one of Ofgem's key responsibilities, in line with the provisions from the Energy Act 2023. On the eligibility of potential code managers, DESNZ noted three factors that would increase risk of a conflict of interest, namely: where the code managers have a profit motive for themselves; 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.

Overall, DESNZ is against adding granularity to the regulations to address these risks specifically, however it proposes that the regulations allow for Ofgem to assess the potential for conflicts of interest as part of its selection process. DESNZ also noted it would prefer not to pursue additional measures in these regulations, such as excluding persons of a particular description from selection or establishing eligibility criteria.

For Ofgem's choice of selection route, specifically whether this should be on a competitive or non-competitive basis, Figure 1 outlines DESNZ's view

**Figure 1 Possible selection of outcomes following an expression of interest**



Source: DESNZ

of how this may occur. DESNZ generally considers non-competitive route would be more appropriate. However, it sets out that Ofgem should consider two factors to decide this – speed of delivery and value for money, alongside other factors such as whether a code has been consolidated or not.

Under a non-competitive selection process, DESNZ proposes that the regulation provide: the ability for Ofgem to select an existing code body directly, if it deems that body to be a viable candidate following assessment; a mandatory assessment of conflicts of interest; and to expressly include provision for Ofgem to form and license an SPV specifically for the code manager role. The regulator itself proposes to consider different approaches to competitive selection, recognising that competition between not-for-profit candidates may not be well suited to a full tender process. Ofgem will consult on competitive regulations in due course.

For the licence duration, the consultation offers the potential benefits and costs of the licence being granted on either an enduring or time-limited basis though offers no preferred approach. The consultation seeks views on this matter.

## 4. Next steps

Responses to the consultation are requested by 5 May 2024, with the closing deadline for Ofgem's consultation on code reform (consolidation) implementation closing on 23 April 2024. DESNZ will also be holding a webinar on 26 March 2024 to outline its proposals from this consultation and to answer questions from those who wish to participate.

A summary of responses will be issued from DESNZ following the consultation, with the next step in the high-level implementation plan being the Secretary of State to designate transitional codes and central systems, followed by a second consultation on implementation by Ofgem.

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