HM Government

Cutting Red Tape

Review of the energy sector

March 2016

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Ministerial foreword

This Parliament, the Government has committed to cut £10bn of red tape as part of our plan to back British business, support jobs and boost productivity.

The Cutting Red Tape Energy Review forms part of this commitment. It has asked businesses, trade associations and industry experts to tell us where regulation causes barriers to growth, innovation and productivity in the energy sector. We also understand that ineffective regulation is not just about rules and legislation but also how it is practically implemented and enforced by regulators.

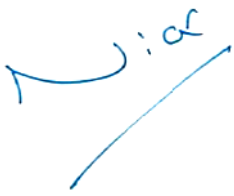
We have spoken to a wide range of businesses, from large and established energy companies to new starters and small and medium enterprises. We found the consultation process insightful and it was enlightening to hear views from such a variety of organisations. The review identified numerous issues and themes – from specific issues regarding how energy storage is regulated to wider more strategic issues such as how the Department of Energy and Climate Change and Ofgem can work with the sector to create more flexible and effective regulation that encourages innovation.

We have taken on board all the findings of the review, and have worked creatively to commit to an ambitious programme of reforms that will develop a longer-term narrative with a clear approach to policy, create a more joined up approach to regulation and will simplify processes and rules, adopting a more risk-based approach to compliance.

Whilst we look forward to the findings and recommendations from the Competition and Market Authority's energy market investigation, we know there are improvements that we can make a start on now on red tape and, where this is the case, we will be doing so right away.

We believe that the commitments made following this review will help to boost productivity, whilst minimising burdens and streamlining how Government and regulators interact with the energy sector.

Matthew Hancock
Minister for the Cabinet Office



Lord Bourne of Aberystwyth
Minister for Energy and Climate Change

Introduction

1. This report summarises the findings of the Cutting Red Tape review of the energy sector.

2. This review examines whether legislation and its implementation can be simplified or improved to aid compliance and to reduce unnecessary burdens on business.

3. This is one of a series of Cutting Red Tape reviews that aims to address issues such as overlap and duplication between regulators, or to identify instances where the legislation, guidance or the approach to implementing regulations is unclear, confusing or unnecessarily burdensome. Each review is a short, sharp investigation of stakeholder experiences and evidence; they are carried out by a small review team and typically involve a six to eight week fieldwork phase.

4. This review was run jointly by the Cabinet Office, Department for Business Innovation and Skills (BIS), the Department of Energy and Climate Change (DECC) and the Office of Gas and Electricity Markets (Ofgem).

Executive summary

5. The Cutting Red Tape Review went public on 16th July 2015 via an online call for evidence. We spoke to 35 companies face-to-face and received a further 36 detailed submissions via email and our website.

6. Companies and trade bodies involved in the energy sector told us that the most significant burdens in the sector were driven by regulation and enforcement, which they considered to be overlapping, duplicated, and not specific enough or not designed with businesses in mind. Smaller companies were particularly affected by the issues raised as they have fewer resources and less cash flow to afford the time and costs of these burdens. Our key findings from the stakeholder consultation process are:

    a) **Sometimes regulation and enforcement isn't specific enough, or is designed in a way which doesn't consider the range of businesses and business models they affect – leading to unnecessary burdens**. Business told us that regulations don't distinguish between a very competitive business to business market, and a less competitive domestic market. We were also told that there is no regulation specific to energy storage and that the permitting regime for offshore renewables is too complex and not designed with businesses in mind. Wind farms told us that the lack of guidance on negotiating with airfields during the mitigation planning process causes a significant financial burden and we were told that aviation interests continued to hold up schemes because of their lack of responsiveness.

    b) **Data Reporting is too frequent, overlapping and can be too onerous**. There are multiple and frequent overlapping data requests each requiring a slightly different format, unnecessarily taking time away from businesses. Specific regimes which businesses told us had particularly onerous reporting requirements were the CRC Energy Efficiency Scheme [CRC], Energy Savings Opportunity Scheme [ESOS] the Climate Change Levy [CCL], the Carbon Price Floor (CPF), the Renewables Obligation [RO] and the Energy Company Obligation [ECO]. Businesses also told us of a number of EU or international treaties which cause reporting or financial burdens including REMIT and the EU Emissions Trading System [EUETS].

    c) **Adhering to the required legislation, codes, rules, and other statements can be burdensome because they are difficult to locate, expensively governed, and sometimes contradictory**. The first burden was as simple as locating all of these rules in their most up to date format. Businesses told us the Licences required to supply energy had grown in complexity and that code changes are costly, especially as they continually change. We were told connecting to the grid can be complicated and expensive, particularly when the infrastructure needs upgrading.

    d) **The scale of change and lack of clear direction from Ofgem and the Department of Energy and Climate Change (DECC) has led to significant opportunity costs and lost investment**. Businesses told us that the scale and process of change is costly, and largely due to the lack of a

joined up approach between all the bodies in the energy sector. We were told that because energy projects take years, and sometimes decades, to complete longer term vision would help secure investment. Businesses told us that they need clear guidance which can be relied upon so they know they can proceed with projects with greater certainty and reduced risk. Companies felt that Ofgem's dual role of regulator and enforcer was not working.

7. In response to these findings, in this Parliament the Government will commit to achieving the following:

   a) **A longer term narrative with a clear approach to policy, which considers the breadth of the market**. The forthcoming Strategy and Policy Statement, which DECC will aim to consult on by Summer 2016, will outline the respective responsibilities of DECC and Ofgem. DECC will also develop, and publish by the end of 2016 a clearer approach to working and communicating with stakeholders in an effective and efficient way and will produce a regular (e.g. annual) forward look – outlining the priorities and key changes in the energy sector over each coming year including, where appropriate, a timetable for Contracts for Difference. Ofgem is committed to "getting out of the way" while maintaining vigilance to protect consumers, introducing clear and robust Impact Assessments for regulatory changes. As part of its Innovation Plan to be published by Budget 2016, Ofgem will continue to consider where its regulation could be more agile, for example to give greater flexibility to accommodate local energy solutions, demand-side and flexible response services, and storage. **These next steps will address the findings in paragraph a and d**.

   b) **A more joined up approach**. DECC and Ofgem have formed a Working Group to look at data and information requests issued by both organisations. This will develop a more streamlined and, where possible, shared approach to making information and data requests to the industry by Summer 2016. This will support industry and reduce burdens by making sure that bodies are as joined up as possible. **These next steps will address the findings in paragraph b**.

   c) **Simplifying processes and rules, and adopting a risk based approach to compliance**. Ofgem is committed to moving to a more principles-based and risk-based approach to regulation, to reduce the size of the supply licence and reducing reliance on prescriptive rules. This will focus on helping companies to do the right thing, as opposed to waiting for them to get it wrong. "Licence Lite" is an option introduced by Ofgem that helps new businesses enter the electricity supply market. DECC will continue to simplify and standardise the reporting processes for Energy Company Obligations (ECO). DECC is currently collaborating on an HMT led review of the business energy efficiency tax landscape and associated regulations, which sought the views of industry on simplification through a consultation process. The review, which DECC aims to complete by Spring 2016, is considering options to streamline energy and emissions reporting. Additionally, the CMA is currently investigating, as part of its energy market investigation, the governance of the Industry Codes and is due to publish its final report in June 2016. **These next steps will address the findings in paragraph c**.

Background

The scope of the review

8. We asked businesses to identify where regulation or the implementation of regulation is causing unnecessary problems. In the context of the legislation, regulation, rules, guidance, licences, etc that exist we asked them:

    - What are your views and experiences on current regulation?
    - What compliance burdens do you face in the sector? Could regulatory aims be achieved more efficiently in other ways?
    - How could regulation be improved to meet the challenges of the future? Is there a way the regulatory framework could more effectively support innovation and disruptive business models?
    - Can innovation reduce burdens on business through more efficient delivery?

9. This review covers the whole energy sector apart from the retail energy markets which are being looked at by the Competition and Markets Authority's (CMA's) energy market investigation; business energy efficiency taxes which interact with energy efficiency policies and regulations and will be considered by a HM Treasury review of the business energy efficiency tax landscape; and new regulatory frameworks currently being established. A further call for comments on retail energy markets will follow once the CMA's Final Report from its energy market investigation is published.

Sector overview

10. Following the liberalisation of the UK energy market in the 1980s and 1990s there has been a marked shift in the sector's regulatory landscape. In the years since privatisation, the government has sought to create a competitive industry and, recently, to achieve the overarching policy goals of reducing emissions, ensuring security of supply and improving the affordability. These goals are known as the "trilemma" and are driven by the Department of Energy and Climate Change.

11. Ofgem is the primary regulator of the UK energy sector, and is a non-ministerial government department. Their principal objective is to protect the interests of existing and future electricity and gas consumers. They do this by aiming to promote value for money, promoting security of supply and sustainability, by supervising and developing markets and competition, and through regulation and delivering Government schemes.

12. The energy sector comprises those organisations involved in the generation, transmission, distribution and supply of electricity and in the storage, shipping, transmission, distribution and supply of gas. In 2013 ONS reported there to be

2,578 enterprises in the sector, estimating an annual turnover of £111 billion and 137,000 employees.

13. Gas and electricity wholesale markets share several common features: trading can take place bilaterally or on exchanges, and contracts can be struck over multiple timescales ranging from several years ahead to on-the-day trading markets. Retail markets provide the strongest point of commonality between gas and electricity, since the products are often sold together by retailers through a bundled tariff called a 'dual fuel' tariff. Moreover, the regulatory regime applying to retail functions generally applies equally to gas and electricity. As of 31 January 2015, there were 27 million domestic electricity customers and 23 million domestic gas customers. There were 19 million dual fuel customers, 8 million single fuel electricity customers and 4 million single fuel gas customers.

14. At a high level, there are some strong similarities between the physical supply chains for gas and electricity. In the electricity sector, different types of generation technology (for example, coal, gas, nuclear or renewable) generate electricity, which is transported to consumers via high voltage transmission lines and low voltage distribution lines. In the gas sector, different sources of gas (eg from offshore fields in the North Sea, imports via interconnectors to other countries or imports in the form of liquefied natural gas (LNG)) are transported to consumers via high pressure transmission pipes and low pressure distribution pipes.

The regulatory landscape

15. The regulatory and policy framework governing the energy sector in Great Britain profoundly affects the shape and nature of the energy market. It is set out in:

    a) EU and UK legislation;

    b) licences, which Ofgem grants to operators for the purposes of engaging in specified activities relating to gas and electricity supply and generation; and

    c) industry codes, which are detailed multilateral agreements that define the terms under which industry participants can access the electricity and gas networks, and the rules for operating in the relevant markets.

16. Roles and responsibilities between Government and Ofgem are allocated in such a way as to ensure that regulatory decisions are taken by the body that has the legitimacy, expertise and capability to arbitrate between the required trade-offs.

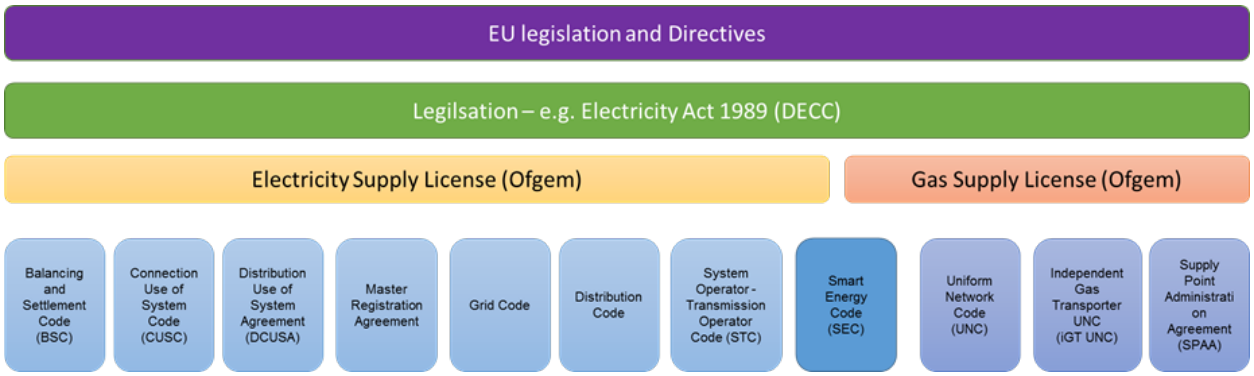


Figure 1: The regulatory landscape

Government

17. The Government is responsible for setting the strategic energy framework and policy goals, including putting legislation before Parliament to set the objectives and duties of Ofgem, safeguarding its independence and equipping it with the right tools to enable it to fulfil its remit. Certain functions in the energy sector are reserved for the Secretary of State, including defining the extent of the regulated industry by deciding on licence exemptions, and appointing members of Ofgem's Board as well as its Chairman. The Secretary of State is a statutory consultee on certain Ofgem powers to set licence conditions, and their consent is required for Ofgem to make particular regulations, such as those prescribing standards of performance.

Ofgem

18. Ofgem is the independent regulator of gas and electricity markets in England, Scotland and Wales and is also designated as the independent National Regulatory Authority for Great Britain under the EU Third Energy Package. Their principal objective is to protect the interests of existing and future consumers, and they do this by promoting effective competition, instigating consumer protections, or by other means. These 'interests' include the reduction of greenhouse gas emissions, ensuring energy security and the fulfilment of objectives under the EU Third Energy Package and Energy Efficiency Directives. Further to this, Ofgem has a number of duties, including ensuring reasonable demands for electricity and gas are met, that licensees can finance their regulated activities, to support sustainable development, and they have specific regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.

19. Ofgem must also have regard to the principles of best regulatory practice, including the principles that regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases for which action is needed.

20. Unless they are exempt, companies need a licence to operate within gas and electricity markets. Ofgem administers the licensing system which energy businesses must comply with. It is responsible for issuing, modifying and revoking licences; setting price controls in the natural monopoly licensed sectors;

and enforcing licence conditions. The licences also require licensees to sign up to a number of multilateral industry codes which contain the detailed rules that govern market operation, terms for connection and access to energy networks. Some codes or parts of codes can only be modified with the consent, or at the direction of, Ofgem. Through its price controls for networks, Ofgem has a key role in the facilitation of efficient investment in our energy infrastructure. Ofgem is also responsible for creating incentive schemes for the transmission system operator and for managing the competitive tender process through which offshore transmission licences are granted.

Other interested bodies

21. Other bodies, most notably the Competition and Markets Authority (CMA) and the Financial Conduct Authority (FCA), also have an interest in the regulation of the energy sector. Ofgem has concurrent competition powers with the CMA in relation to competition in gas and electricity markets while the FCA has powers to investigate some aspects of the wholesale energy markets. Under the concurrency arrangements, the CMA or Ofgem will be responsible for a case depending on which of them is better placed.

22. Ofgem is required to cooperate with the European Agency for Cooperation of Energy Regulators (ACER) which was established to promote cross-border competition and other single market activities. Ofgem must comply with legally binding decisions of ACER or the European Commission.

23. Offshore energy companies will typically come into contact with a broader range of regulators through their permitting activities, potentially including: the Maritime and Coastguard Agency, the Civil Aviation Authority or the Ministry of Defence, the Environment Agency and the Marine Management Organisation.

24. The Health and Safety Executive (HSE) is a non-departmental public body sponsored by DWP. It is responsible for the encouragement, regulation and enforcement of workplace health, safety and welfare, and for research into occupational risks in England, Wales and Scotland. Relevant to energy, HSE have sector strategies for Electricity and Gas and pipelines and is responsible for the Control of Major Accident Hazards Regulations 1999 (COMAH), via the COMAH Competent Authority (CA). The COMAH CA is part of HSE and seeks to protect people and the environment from, and limit the consequences of, major accidents occurring within establishments covered by COMAH 2015.

Findings

25. Energy companies told us that the most significant burdens in the sector were driven by regulation and enforcement, which is overlapping, duplicated, and not specific enough or not designed with businesses in mind.

26. The following section sets out our key findings from the stakeholder consultation over the process of the review. All findings, including assessments of costs, were provided by individual respondents and companies and do not reflect the Government's assessment of potential savings.

a) Sometimes regulation and enforcement is not specific enough, is designed in a way which does not cater for businesses' needs, or does not consider the range of businesses and business models they affect – all leading to unnecessary burdens.

27. **Business told us that regulations don't distinguish between a very competitive non-domestic market, and a less competitive domestic market**. We were told the supply licence demands very prescriptive ways of handling complaints for domestic and microbusiness customers, which are suitable for domestic households, but less appropriate for businesses. Companies said it included them in the faster switching scheme, despite the mechanism for energy brokering for Business to Business [B2B] being very different to domestic supply. We were told they felt 'straightjacketed' because they are compelled to deal with all customers the same way as the domestic suppliers in some instances. For example, they cited the requirements of the Complaints Handling systems which are very process heavy and may not suit some of the larger microbusinesses.

28. **Businesses told us that there is no regulation specific to energy storage**. This means that it is currently regulated as generation. Businesses told us that because energy storage is regulated as generation, Distribution Network Operators [DNOs] are legally not allowed to own them. We were also told that when storage exceeded 50 MWh it was regulated differently, and is charged twice – once when it is stored, and then again when it is released. One business told us this cost them £11m in one year. We were told a number of schemes which could be larger are specifically designed to be 49.9 MWh to sit below this line. A trade body suggested that an increase in storage would lead to a reduction in constraint payments as electricity could be more easily released onto the network, and excess captured. In 2014-15 the National Grid levelled £227m in constraint payments against companies, and Ofgem forecast that there will be a further £288m - £402m by 2020-2021. This includes constraint costs that are to arise from DECC's 'Connect and Manage' grid access.

29. **Offshore renewable energy companies told us that the permitting regime was too complex, doesn't take into account existing information, and is not designed with businesses in mind**. We were told that the permitting process can involve gaining a seabed agreement from the Crown Estate, obtaining a Section 36 agreement to produce electricity from the Marine Management Organisation, a Marine License from Natural England (or equivalent in Wales

and Scotland), a Safety Zones Consent from DECC, undertake a Water Framework Directive Compliance Assessment, produce a fully cost Decommissioning Scheme for DECC, a licence from the General Lighthouse Authority and finally a cable license. One company told us that this entire process, including application fees, legal fees and resourcing cost them £75,000. This is separate from all the steps needed to actually sell the electricity. Further to the complexity of obtaining the permits, businesses told us there aren't any set timescales for the application process which causes increased uncertainty. One company told us that after submitting applications for permits they had to wait a further 18 months for a decision to be made which they told us is a significant problem when it comes to attracting investors. We were told the role of Demonstration Zones in obtaining Seabed Agreements from the Crown Estate was working well. This initiative invites landlords to bid for areas, after which third party managers can add value by improving infrastructure and obtaining licenses. There are currently 6 Demonstration Zones and businesses would like to see more of these.

30. **Businesses told us that there were variations in the way data had to be collected and submitted for the English, Scottish and Welsh agencies as part of the permitting process**. One business told us that they were obliged to send a ship into the North Sea to monitor bird life for two years before they could apply for permits, and that this cost them £100m. Businesses told us that they would like to see a more risk based approach to environmental data monitoring. An example given is the "deploy and monitor" approach adopted by Marine Scotland, which has proved the least burdensome. This allows for the data collection to start after the project has started. Businesses stressed that if this approach is adopted throughout the UK then more investors will be attracted to British renewables projects.

31. **Wind farms told us that the lack of specific time frames and regulation on the permitting process for airfields can cause a significant time burden, and lead to costly mitigation and uncapped indemnities**. Wind companies are required to obtain agreement from both civilian and military airfields in order to get planning permission, as the turbines can affect primary and secondary radar. We were told that there is no regulatory obligation on airfields to respond to mitigation consultations and the response rate varies depending on the airfield. One airfield even charges £30,000 simply to engage with wind farms over mitigation. We were also given the example of an airport that didn't engage with the consultation at all. As there were no legal options available due to the lack of regulation for the mitigation process, the company was resorted to contacting the MP in order to get a response. Once the airfield responds, the wind companies are then required to pay for mitigating any risk the farm will have on aviation. This usually requires the developer to pay for a solution acceptable to the air traffic control company, typically a new radar system. In addition to the solution the air traffic control company requires the developer to grant an uncapped indemnity in respect of aviation issues that arise as a result of the wind farm. Uncapped indemnities like this increase borrowing and project finance costs for developers. For example, one company told us that an airfield requested a new radar system which cost £3.5m, with an uncapped indemnity and a shutdown clause in the event of the radar failing. Additionally, wind farms

are obligated to pay the legal fees for both sides, which one company told us can cost up to £80k per project, and for specialist consultants, which we were informed cost up to £50k. This is a significant barrier to entry for smaller wind farms, for whom this could pose a significant up front expense before consent for the farm has even been gained. Wind companies told us that they accepted the responsibility for upgrading radars but they didn't accept they should be expected to agree to uncapped indemnities. We were told that, with radar technology developing, the Government should acknowledge that, by 2020, all airfields should install radars with wind farm detection capabilities included as standard. One business told us that the mitigation process works much more smoothly when dealing with the Ministry of Defence (MoD). One example that was given to us was the mitigation negotiation over an air defence radar for the MoD. It was agreed that the wind farm should pay multiple millions of pounds for the new technology, with an additional tens of thousands of pounds per year for maintenance and a multi-million pound bond that was returned following initial tests of the new radar. Whilst this was expensive, they valued the certainty it offered investors, and that it didn't increase their rate of borrowing. This increased certainty is more attractive to investors.

b) Data Reporting is too frequent, overlapping and can be too onerous.

32. **There are multiple and frequent overlapping data requests each requiring a slightly different format, unnecessarily taking time away from businesses**. Businesses told us requests for information came from actors across the energy sector, including: DECC, Ofgem, National Grid, and the code administrators, but also Citizens Advice, and companies listed in section 68 of the Serious Organised Crime Act 2007, for example Experian. Businesses told us that each one that required a different format cost them additional time or money when they have to update their IT systems or methodologies. One company told us they had to spend £960,000 just updating their IT and £750,000 on specialist staff over a two year period; and a power plant told us that half of their staff were working on computer updates to meet data reporting requirements. Businesses told us that a number of the requests they received were on top of those obliged by the licences, with multiple requests, sometimes for the same information, from officials within DECC and Ofgem to inform policy decisions. Businesses said that a large number of these requests were for cost or supply data, which DECC should already have from the Digest of UK Energy Statistics [DUKES] and the metering data which they automatically receive, or would be held by other Government departments. Businesses also cited non-financial audits as a significant drain on their time – with one company saying they had five audits from code administrators and Ofgem in one year. We were told that if data was better shared across departments and between administrators it could reduce the burden on businesses.

33. **Some businesses noted the onerous reporting requirements of specific regimes**. One organisation told us that a proliferation of complex policy tools requires the same energy to be reported multiple times for different purposes, with different reporting timescales, different schemes, different administrative processes and fees and different prices for CO2. Companies are obliged to report energy use and Greenhouse Gas emissions for the purpose of administering a number of programmes and taxes, including the EU Emissions

Trading System [EUETS], CRC Energy Efficiency Scheme [CRC], Energy Savings Opportunity Scheme [ESOS] the Climate Change Levy [CCL], and the Carbon Price Floor (CPF). This places a significant time burden on companies. Biomass companies reported that under the Renewables Obligation (RO) generators have to submit rolling monthly output data, including sustainability information per consignment of biomass; confirmation that it is compliant with land criteria or timber standard; as well as a Green House Gas emissions value. Companies also told us that the extent of the paperwork involved in proving the delivery of the Energy Company Obligation [ECO] were very onerous. One company told us that they had to produce up to 50 documents with each fit of a building. Documents have to be provided by those across the supply chain meaning a large number spend time filling these in.

34. **The EU Regulation on Energy Market Integrity and Transparency (REMIT) was seen as having particularly burdensome and time-consuming reporting requirements**. REMIT creates a regulatory framework for wholesale energy markets and aims to prevent market abuse (notably market manipulation and insider trading). It imposes reporting requirements on market participants, including energy trading companies and producers of electricity. Energy traders are required to report every transaction regardless of their number. One trader told us they had to report 200 transactions every day despite the fact that their transactions constitute less than 0.1% of the energy market which – in their eyes – makes insider trading impossible. To meet these reporting requirements businesses told us they have had to build and operate bespoke IT systems causing additional costs. Energy producers told us that as soon as there is a fault it has to be reported on in a very technical manner in a short timeframe. They said that instead of fixing the problem they are occupied with reporting requirements and disclosure obligations which costs them money since they are not supplying energy and face fines from the National Grid. They said there was no clear criteria as to what should be reported on and there could be more guidance on the implementation of REMIT. We were also told that there is a vast duplication of data since they are sent to five different places.

c) Businesses told us that adhering to the required legislation, industry-owned codes, rules, and other statements can be burdensome because they are difficult to locate, expensively governed, and sometimes contradictory.

35. **The first burden was as simple as locating all of these rules in their most up to date format**. Businesses told us that there were numerous layers of rules which may or may not apply to them, from primary legislation, regulations and other secondary legislation, written ministerial statements, licences, Ofgem rulings, and the codes. Businesses expressed frustration at the difficulty of having to spend time trying to find all of these documents, and then still not knowing if they had them all or not. Industry documents and guidance are spread across a range of organisations such as Ofgem, National Grid and individual network companies. This is seen by business as adding layers of complexity for companies to negotiate, which they consider adds cost to the service they provide.

36. **Businesses told us the Licences have grown in complexity**. We were told that it can cost a lot to understand which aspects of the rules apply to them due to their complexity. Ofgem's licences have increased in size over time, with the Supplier Licence growing almost four times since 2004. These licences empower the codes by requiring them to be adhered to – which are 10,500 pages of industry owned guidance. One company stressed: "The compliance burden is substantial given the prescriptive nature of the licences and the extremely detailed provisions in the relevant codes."

37. **Businesses told us that the complexity of the codes leads to a significant burden on them**. Each code has a different code administrator, and costs businesses money to join. This can vary from a one off fee of £5,000 to an annual payment of £3,000 a year. Code administration is costly: four of the administration bodies (Elexon, XoServe, Gemserv and Joint Office) had a combined total operating budget of around £70m in 2013-14. Each code has its own governance structure, and own way of doing things, leading to multiple differences and added burdens on businesses considered costly. This is everything from the definitions of words differing between the codes, to different agreements having been brokered between the Health and Safety Executive and each code administrator leading to different requirements for comparable activities. Businesses spoke of outdated ways of working – with paper based forms adding costs and time to processes. Newer companies told us that the more historic elements of the codes typically favoured the older model of a vertically integrated energy company. This unnecessary complexity adds additional burdens on businesses.

38. **Businesses told us that the existing process for how the codes are changed leads to a significant burden on them**. Each code has a different process for how code modifications are brought about, and these are very frequent, with 2 – 4 code modifications a week. As one business told us: "It's never ending. We have no time to engage with code panels, and changing codes. Makes it very difficult to influence and change." Another company noted that often go-live dates are set for big programmes, without enough consideration for the number of code changes required and the length of time these take. This often leads to a reduced time for companies to put the changes into practice before the programme comes into force.

39. **Businesses told us it is costly to keep engaged with the number of proposed changes just on the codes with around 500 each year**. We were told larger firms hire 2 or 3 specialists per code, and smaller companies pay £20,000 for consultants and half a staff member in house all just to keep on top the changes. This was considered essential to try and make sure these changes didn't adversely affect their businesses. However, smaller companies still felt that changes were less favourable for them and, due to their limited staff focusing on the changes to the codes, they had less time to work out the impact each of these proposed changes would have on their cost base in the longer term. Businesses told us part of the reason for this was because some of the codes were run in an opaque way, with websites password protected, lists of ongoing consultations impossible to find in the public domain, and despite multiple requests to be added to 'open' mailing lists – this still not having happened months later. Further, businesses told us that the codes are slow to adapt to

changes in other codes or regulation, resulting in codes often conflicting or contradicting each other, or the licence or legislation. One business told us: “A large number of consultations on code changes are only ever responded to by those who proposed them in the first place. They’re either written in such a complex way that no-one can understand it, or companies just can’t afford to engage with them, or because the changes are so minor and inconsequential for everyone apart from the one company proposing it, that people don’t care.”

40. **Some businesses told us that connecting to the grid can be complicated, inflexible and expensive, particularly when the infrastructure needs updating**. One company told us that: “Despite generation developments often being for a limited duration (such as a wind farm with an operating life of 25 years) network operators continue to seek permanent or longer term rights for their equipment to remain in place as they would for planning or upgrading their networks. This can be the case even where the developer is paying for the equipment to be installed at a cost of hundreds if not millions of pounds.” When a grid connection offer is given, the network operator includes an ability for it to vary the price and dates for a connection which can add significant cost and uncertainty to a project. We were told that: “a developer has no choice but to accept the terms of the connection offer or such increased costs and changed timescales.”

41. **We were told that, when connecting to the grid, network companies operate different processes making it harder for businesses operating across the country**. One company told us that: “This can create significant uncertainties when developing and constructing generation projects. Given the monopoly position of the network companies (which mean that a generator can only deal with the network operator for the area in which a project is situated) and the terms of industry documentation which generally applies to the whole of the UK, it can act as a barrier to entry to the market for generators who need to adapt projects to meet different network operator requirements. Further, these inconsistencies make different parts of the UK more attractive for developing generation projects than others.”

d) Businesses told us that the scale of change and lack of clear direction from Ofgem and DECC led to significant opportunity costs and lost investment.

42. **Businesses told us there were 400-500 consultations last year excluding code modifications, going up to 800-1,000 when included**. These changes came from DECC, Ofgem, National Grid, and other bodies – and businesses said they felt the coordination between these bodies was limited. Smaller companies found it particularly difficult to engage with these changes and model the impacts the potential changes would have on their cost base. Businesses told us the mix of constant change, and difficulty of accurately modelling long term costs and profits, has a destabilising effect on investment. Businesses told us that the amount of change made the market very unattractive to foreign investors who were looking for steady returns and could compare energy markets from country to country. A company told us that, on one of their solar projects, their foreign financiers decided not to invest explicitly because the legislation had changed every 6 – 12 months. We also spoke directly to an investor who told us that, if the pace of change continues, it will destabilise

inward investment. Another business summarised it as: “Everything seems to constantly change - transmission charges, capacity mechanisms have already changed, and there’s another consultation for further changes. In Gas, the UNC gas code means more changes. This policy and regulatory uncertainty undermines investment.”

43. **Businesses impressed upon us that the amount of change and the way in which it is currently done is largely due to all the bodies in the energy sector not being as joined up as they could be**. We were told that DECC, Ofgem, the National Grid, Code Administrators and others often attempted to fix the same problems simultaneously but with different approaches and regulatory interventions. This leads to a large amount of change, with a layering affect which may undermine any one of those changes, and makes evaluating the success of any one intervention extremely difficult.

44. **We were told that, because energy projects take years, and sometimes decades, to complete, longer term vision would help secure investment**. Businesses asked for prioritisation of the trilemma (energy security, affordability, and sustainability), and a long term view on the desired energy mix in the UK. We were told a clear direction would give confidence in the stability of the framework and encourage investment. A particular example a number of companies pointed to was around Contracts for Difference. Whilst these were broadly welcomed, companies highlighted certain elements which held investment back. Generators felt that the process took place at too late a stage of the building cycle. They have to pay millions of pounds into a project before they can get it to a point where it can qualify to apply for a contract. They compared this to other European countries which offer contracts at a much earlier stage in a project, and on a significantly longer time frame – meaning companies can leverage more investment from the private sector. It was noted that DECC had yet to publish a clear timetable for when future rounds would be held. Companies planning multi-million pound projects with significant investment from other parties, needed be able to work towards clear timeframes and milestones to know at which points the projects could apply for contracts to guarantee the supply of electricity.

45. **Businesses told us that they need clear guidance which can be relied upon so they know they can proceed with projects with greater certainty and reduced risk**. They said Ofgem refuse to offer guidance on hypothetical situations. One example a company offered us was of an instance where the preliminary accreditation for a FIT Project required the company to have a valid Grid connection, whilst their project drew upon another landowner’s grid connection. Having already invested tens of thousands of pounds in the project, the wording made it unclear whether they would be allowed to proceed with the application under their neighbour’s name, or if they were required to own the grid connection themselves, which would likely set them back a further £20k and a lot of time. Ofgem were unable to clarify in the pre-accreditation period, or during the application period. We heard that when Ofgem does offer guidance or advice it is always caveated that companies shouldn’t rely on it. Companies are told that even if they follow all of Ofgem’s guidance to the letter, Ofgem can still enforce against companies if it turns out their guidance was wrong. This results in

companies paying for legal advice to double check all of Ofgem's advice. Smaller companies found this particularly burdensome and unaffordable.

46. **Companies felt that Ofgem's dual role of regulator and enforcer was not working**. There was a general sense of distrust that they couldn't have an open and frank conversation with Ofgem's policy teams, in case information was then shared with their enforcement colleagues, who would then level fines against them, rather than being used to help them fix their problems. Companies felt that as Ofgem moved into a principles based regulation a much more collaborative relationship would be required to ensure the best outcomes.

Next steps and recommendations

47. Taking on board the points raised by the energy industry, Government is committed to reducing the burdens imposed on the energy industry. This parliament, Government will commit to achieving:

    a) A longer term narrative and approach to policy, which considers the breadth of the market;

    b) A more joined up approach;

    c) A risk based approach to compliance.

Detail

a) A longer term narrative with a clear approach to policy, which considers the breadth of the market

48. **Following the publication of the CMA report in June 2016, DECC aims to designate a Strategy and Policy Statement. This will set out in detail the respective roles of DECC and Ofgem, and will provide a strategic framework within which Ofgem are to operate**. This will provide much needed clarity for businesses and other stakeholders. This will be subject to Parliamentary time but there will be a public consultation prior to designation, likely to begin in Summer 2016.

49. **DECC will work to produce a regular (e.g. annual) forward look – outlining the priorities and key changes in the energy sector over each coming year**. They will strive to make the policy making process more predictable. This forward look of the focus will help businesses to plan their engagement and allocate resourcing sensibly, as well as forecast the things likely to be coming up.

50. **DECC have announced the timetable for the next allocation round for Contracts for Difference, which is due to take place before the end of 2016, with two more following before the end of this Parliament**. Foreign Direct Investment projects (amongst other investment indicators) are currently tracked and counted by the Virtual Team function in UK Trade and Investment for major companies, and by the appropriate sector teams for smaller companies.

51. **DECC will bring greater clarity to the policy process by developing, by the end of 2016, a clearer approach to working and communicating with stakeholders in an effective and efficient way**. Part of this will entail dedicating time to identify the specific audience the policy change is intended to affect, and writing it in a targeted way to ensure it doesn't unduly affect other energy sub-sectors. This will build on the work of having a webpage offering targeted support for independent suppliers with relevant documents, policies and consultations, and advice. Regulatory policy will encourage industry to make greater use of piloting and trials to drive innovation to benefit consumers.

52. **Ofgem will consider how its statutory duty to undertake Impact Assessments can best meet new duties to reduce burdens**. Ofgem has a statutory duty to undertake Impact Assessment in certain circumstances and will work with stakeholders to understand the implications of proposed new duties in the Enterprise Bill, to ensure that its assessments of the regulatory impact on businesses remain clear and transparent.

53. **DECC will consult on the storage of electricity in the network in spring 2016**. DECC is working closely with Ofgem to examine how existing legislative ambiguity, such as being licensed as generation, can negatively impact storage projects. DECC will consider options open to themselves and Ofgem for clarifying the legal status of storage. DECC will explore whether additional changes to regulatory and commercial frameworks are needed to reflect the unique offering of storage in our energy system.

54. **Ofgem is committed to "getting out of the way" while maintaining vigilance to protect consumers**. Reforming licence and code requirements should reduce barriers to entry, provide space for innovation and potentially enable a wider range of service offers in the sector. Ofgem is continuing work to explore the scope for innovation to offer positive and potentially disruptive change, including extensive engagement with organisations that are developing "non-traditional business models".

55. **As part of its wider work, Ofgem is continuing to consider where its regulation could be more agile, for example to give greater flexibility to accommodate local energy solutions, demand-side and flexible response services, and storage**. In taking this forward, Ofgem will also consider the overall future shape of the energy sector, to make sure that innovative business models maintain effective consumer protection and comply with shared obligations, for example around use of network infrastructure. Further details of this approach will be outlined in Ofgem's Forward Work Programme, to be published in March 2016, and in the Innovation Plan to be published ahead of Budget 2016.

56. **Ofgem notes that the completion of a number of a number of network upgrades, including the Western High Voltage Direct Current (HVDC) Link between Scotland and North Wales, will lead to a decrease in constraint payments**. Ofgem asserts that constraint payments are not an inefficient 'wasted' cost that storage could solve, but an efficient alternative to building more transmission capacity. While storage may be able to alleviate some of these constraints, it's not clear whether it could do so at less cost than paying generators to turn off.

57. **The Ministry of Defence (MoD) is committed to continue working proactively with the Wind Industry to find innovative ways of enabling wind turbines to co-exist harmoniously with military Air Defence and Air Traffic Control radars**. The Air Traffic mitigation process has undergone significant development in 2015, with input from the wind industry via the DECC led Aviation Management Board and also via the Renewable UK Industry Group. The process is currently being refined whilst wind industry feedback is being considered, and the MOD has committed to make the process freely available to

all in due course. For Air Traffic Control radars, there is no proven mitigation technique and the safety considerations are significantly more challenging than for Air Defence. However, The MoD is currently working with a group of consented offshore and onshore wind farm developers. Working closely with key stakeholders from the civil aviation community and with the Civil Aviation Authority (CAA) regulator, MOD has proposed a way forward that has the potential to release up to 3.3 GW of renewable energy, which will take the UK a considerable way forward in meeting its 2020 renewable energy target.

58. **The Department for Transport [DfT] acknowledges the importance of guidance material being available to windfarm developers in respect of mitigating the impact of wind turbines on aviation**. The principal guidance document is published by the Civil Aviation Authority and is CAP764. This document is updated regularly with the help of both the aviation and windfarm industries. When considering this document, the CAA is also helped by its Windfarrm Working Group (ASIWWG) which includes membership from DECC, NATS, airports, MoD, DfT, the GA community, and Renewal UK. A further update to CAP764 is imminent, but if the windfarm industry has any ongoing concerns with the text of this document they are encouraged to raise them with the CAA as it is important that the document continues to be up to date and reflect best practice.

59. **DfT understands the rationale for why the windfarm industry would welcome a situation in the future that all radars are windfarm compliant**. This is a perfectly understandable objective, but is, unfortunately, not realistic in the timeframe suggested. Radars take many years to design and then put into service, and can then be in operational service for more than 15 years. Consequently, radars being designed today may still be in operational use in 2 or even 3 decades time. However, it is important to recognise the achievements of the DECC led Aviation Management Board which has brought together the aviation and windfarm communities with a common objective of finding solutions which, whilst ensuring that air safety is maintained, enables the maximum number of developments to proceed. Over the last 6 years, the amount of aviation objections has fallen very significantly – perhaps as much as 90%. New innovative solutions, such as the Raytheon Modification put forward by NATS and partly sponsored by Government, have come to the market. The aviation industry has also been willing to agree a number of transponder mandatory zones and other technical solutions which have enabled its objections to be overcome. Whilst the current situation may not be perfect, the Government considers that we are in a far better place today than just a few years ago. This is a testament to how well the two industries have worked together to ensure that windfarm development has been able to progress at pace in the UK without compromising the overriding need for air safety.

b) A more joined up approach

60. **DECC and Ofgem have committed to find ways to streamline data and information requests, and are forming a working group to deliver this**. DECC and Ofgem accept that fewer, more comprehensive requests and better sharing might remove pressure. This group will look at what requests are being issued, and to develop more streamlined and, where possible, shared

approaches by Summer 2016. DECC will also consider how to extend these principles relating to data requests to National Grid and code bodies.

61. **As part of the work highlighted in bullet a paragraph 50 DECC will outline how they will work with industry to reduce burdens by making sure that bodies are as joined up as possible**. This extends to policy interventions, consultation exercises and data requests. The proposed approach to working with industry will include how DECC and Ofgem can better work across the sector to tackle issues with a more joined up approach.

c) Simplifying processes and rules, and adopting a risk based approach to compliance

62. **The CMA is currently investigating, as part of its market investigation, the governance of the Industry Codes and is due to publish its final report in June 2016**. Once this is released DECC and Ofgem will look at how code governance can be streamlined, in line with these findings, to reduce the burdens caused by them on businesses. DECC and Ofgem consider the current approach to code administration is creating regulatory burdens and welcome CMA attention in this area. The Government is committing to implementing any recommendations made by the CMA.

63. **Ofgem is committed to moving to a more principles-based approach to regulation, to reduce the size of the supply licence and reducing reliance on prescriptive rules**. This puts far greater emphasis on energy companies to understand what is right for consumers and to deliver good outcomes. This approach has a strong focus on encouraging suppliers to get it right the first time by anticipating and proactively addressing the needs of their consumers. Ofgem is committed to ensuring that companies deliver positive consumer outcomes, and will take strong action when needed to help companies put things right. Where companies fail their customers, Ofgem will continue to take a risk-based approach to enforcement, targeting its resources to ensure that customers receive a level of service consistent with an essential service such as energy. Ofgem consulted on its strategy for future retail regulation and will confirm the way forward in Summer 2016 following conclusion of CMA's investigation. Developing the proposed approach will include mechanisms for monitoring, guidance, compliance and enforcement. An important aspect of this will be to consider burdens on business, including in relation to requirements on regulators proposed in the Enterprise Bill.

64. **Ofgem will continue to adopt a risk based approach, which is focused around encouraging suppliers to get it right first time, by anticipating and proactively addressing the needs of their consumers**. Ofgem completed its Enforcement Review in 2014, to bring greater clarity, consistency and transparency to its enforcement policies and processes. Ofgem's prioritisation criteria for deciding whether to open or continue a case are risk-based, with decisions taken on a case by case basis looking at the facts of the matter. Reviewing monitoring requirements for the supply licence forms part of the work noted above on future retail regulation.

65. **“Licence Lite” is an option introduced by Ofgem that helps new businesses enter the electricity supply market**. In “Licence Lite”, a prospective new supplier partners with an existing supplier that takes responsibility for some of the more costly and technically challenging parts of the supply licence. In particular, the “Licence Lite” model allows new entrants to rely on existing suppliers to meet the most onerous industry code requirements. This enables market entry by a greater diversity of organisations, as “Licence Lite” does not require the capability to interact with the more technical aspects of the energy system. “Licence Lite” could be particularly useful for distributed generation or organisations that want to supply in a particular area, such as local authorities. These initiatives focus on the supply licence, where licence burdens in particular driven by code requirements are most prevalent. In other parts of the sector, licences are less burdensome. Indeed, small and medium-sized generators do not need a licence at all. Ofgem is continuing to work with potential applicants for 'Licence Lite' and will monitor interest in the opportunities the option provides.

66. **DECC will continue to simplify and standardise the reporting processes for Energy Company Obligations (ECO)**. The current phase of ECO ends in March 2017. For the successor programme DECC is exploring with industry how the administrative burdens can be reduced, including through the simplification of guidance to make it easier for businesses to understand and respond to the requirements. One option being considered (subject to consultation) is the use of ‘deemed scores’ to make it easier to show what will be achieved by the installation of measures. DECC is keen to ensure that the measures installed in consumers’ homes are of the right quality. Peter Bonfield has been commissioned to conduct an independent review of quality and standards that will conclude in March 2016. Once this review has concluded, DECC will make sure it adopts a risk-based approach to compliance checks where companies delivering to a consistently high standard are rewarded with less monitoring.

67. **DECC is currently collaborating on an HMT led review of the business energy efficiency tax landscape and associated regulations, which sought the views of industry on simplification through a consultation process**. The review, which government aims to complete by Spring 2016, is considering options to streamline energy and emissions reporting. and has the ambition of ensuring that (with the exception of the EU Emissions Trading System which is an EU requirement), any business will face a single domestic energy tax and reporting framework. This review is also considering the role of DEFRA’s mandatory GHG reporting for listed companies.

68. **The reporting requirements of REMIT and the associated enforcement regime were carefully designed with minimum Europe compliance in mind and to provide consistency with financial regulations regime**.

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BIS/16/158