

# **Creation of the governance entity, governance of the governance entity and administration of charging methodologies**

## **A paper by NGT for DISG**

### **Background and purpose of this note**

In its decision document, Agency and Governance arrangements, Ofgem has stated its position regarding the creation of a governance entity for network code and charging methodology administration.

Ofgem has stated that a governance entity should reduce the potential for undue discrimination and to better facilitate transparency of the governance processes.

Ofgem has also stated that the governance entity should administer the process for changes to the charging methodologies of gas transporters.

Further to these conclusions, NGT has been requested to begin to develop further detail on the following:

- The constitution of the governance entity
- Governance of uniform network code modifications and
- Administration of charging methodologies

and in doing so to have regard to the views expressed in the DISG.

This note addresses these issues.

### **Assumptions relating to the governance entity and its functions**

The following assumptions underpin NGTs proposals.

The proposal for transportation arrangements following DN sales is a preservation of the principal tenets of the Network Code and associated arrangements, including the definition of the 'System' and the current transportation price controls. Accordingly we assume that identical conditions within the Gas Transporter's licences of the NTS and each DN will:

- set a shared common relevant objective (the coordinated economic and efficient operation of transportation arrangements in respect of the NTS and the DNs);
- require them collectively to establish a Uniform Network Code (UNC) and modification rules;
- operate collectively the modification rules;
- require them to develop and administer individual transportation charging methodologies and changes thereto using a common process;
- recognise the collective utilisation of an agent for the discharge of certain UNC obligations on their collective behalf and
- require them to provide common systems to undertake the data processing and transactional functions within UNC.

### **The Governance Entity and its funding**

NGT considers that the establishment of a joint office (unincorporated) of Gas Transporters (GTs) could be an appropriate vehicle to discharge the joint obligations of GTs, for the remainder of the existing period of this price control.

NGT is currently developing detailed proposals for the constitution of such organisation. Proposals are still at an early stage but it is envisaged that a Joint Operating Agreement would establish the Entity and its operating arrangements. NGT welcomes comment on the following issues :

- Membership: would members be drawn from GTs – consistent with the discharge of obligations that the GTs will have in their licences?

- Would separation from the staff of GT members be required? For Day 1 could it potentially utilise a discrete restricted-access area within a member's existing building?
- Would organisational separation from GT members be required? Would Governance Entity staff be prevented from working concurrently for a GT? Would this inhibit the practical benefits of allowing subject-matter experts to be seconded in, either on a project by project or longer-term basis?
- Would it be funded by subscription fees in line with current price controls? What mechanisms would be used to implement this?
- Codification of the detailed functions of the Entity, the scope of its delegated authority to act on members' joint behalf, provisions for appointing staff, etc

The size of the Governance Entity is a matter requiring careful consideration. If the Governance Entity is to be fully self-sufficient then a certain critical mass of skilled capability is implied, together with an increased number and frequency of meetings. A focus on less bureaucratic and more economic/efficient operations might envisage a core Governance Entity secretariat working routinely with subject-matter experts within the GTs (and Shippers) to develop reports. A middle route might be to permit frequent short-term secondments of topic specialists from the GTs into the Governance Entity on an equitable basis. Provided that a Code of Conduct were observed, and over time core capability developed among permanent Governance Entity staff, this could deliver a pragmatic Day 1 solution in terms of administration, funding, economy and efficiency.

### **Functions of the Governance Entity**

It is proposed that the governance entity will be accountable for the following functions:

- publication of the Uniform Network Code (UNC) and its modification rules
- running the UNC modifications process :
  - convening and chairing meetings of the UNC Modifications Panel and UNC Code Committees
  - drafting and issuing consultations
  - commissioning impact assessments, including (acting as the representative of the GTs) the commissioning of IS system impact assessments from xoserve
  - drafting UNC modification reports and submitting them to the Authority
  - following approval of a Modification to the UNC, commissioning the necessary IS system changes to enable the modification to be implemented (acting as the representative of the GTs)
- providing administrative support to the charging methodology review process
  - hosting periodic meetings of DNs to manage charging methodology change proposals
  - submitting charging methodology change proposals to the Authority

### **Operation of the Modification Panel and associated process**

As a general principle, NGT's proposal is that the current Network Code modification rules would be 'hived up' to UNC level, and amended where necessary to accommodate multiple transporters and deliver incremental improvements where change is thought appropriate. These could include:

#### **1 Composition of the Panel – voting members**

[50]% of the voting members would be User (shipper) representatives, elected as now by the Gas Shipper Forum. The other [50]% would be GT votes, with the NTS owner being allocated [10]% and DN owners [40]%. The total number of members will need to be set such that a balance is struck between adequate GT owner representation and unwieldiness. Each member's vote could be exercised by proxy by a member of the same constituency or by the Panel Secretary.

#### **2 Composition of the Panel – non-voting members**

The current arrangements, whereby non-voting seats are included as panel members, would continue. We would expect the interests of producers, terminal

operators, suppliers and consumers to be represented in this way and, given the Panel's ability to make recommendations (see below), we would expect to see an increase in current attendance levels. 'Independent' members (drawn for example from other industry panels) could also serve as non-voting members, if their presence were judged to be of significant value.

### **3 Composition of the Panel – Chair**

A senior member of the Governance Entity staff would, in an administrative capacity, chair the Modification Panel

### **4 Voting rights**

The simple majority rule would apply. In the event of a tie the Chairman would exercise a casting vote.

### **5 Role of the Panel – process**

As now, the Panel would be required to vote on matters of process.

### **6 Role of the Panel – opinion**

The Panel would, inter alia, be empowered to:

- **Establish terms of reference** and the **associated timetables** when referring proposals for development
- **Express an initial view** either collectively or individually, at the meeting or shortly thereafter, for incorporation in the Draft Mod Report (DMR).
- **Make a recommendation** in the Final Mod Report (FMR). If the Panel's decision were not unanimous among all members whether voting or non-voting, an outline of the balance of opinions could be given. In the event that unanimity was hindered solely by virtue of dissenting non-voting members, the fact would be recorded as "voting members unanimity". This is consistent with the operation of the new appeals procedure. It would also be appropriate for GTs (individually or collectively) to have the opportunity to make draft recommendations in the DMR and/or recommendations in the FMR, to the extent that they consider that the proposed modification will have an impact on their ability to effectively discharge their licence obligations.

Furthermore, GTs would still be able to express their individual views by way of separate written representations outside of the Panel report itself. The secretariat process could facilitate this by providing for any GT opinions to be routinely appended to the FMR.

The status and roles of non-voting members, including their ability to express views and make recommendations, would remain as now.

### **7 Panel members' ability to see reports in draft**

One of the functions of the secretariat will be to compose a summary of representations received in respect of a modification. NGT envisages a mechanism that allows a period within which relevant parties may raise reasonable objections to the draft documents (whether representations, opinions or recommendations). This ought to assuage existing concerns relating to Transco's discretion in this area, consistent with the way in which Amended Standard Condition 9.9 (iii) to (v) of Transco's Licence is applied in a multi-transporter environment.

## **Charging Methodologies and the operation of the Review Procedure**

### **Current Arrangements**

Under current arrangements, Transco is required under Amended Standard Condition 4 of its GT licence to provide 150 days notice of its intention to change its charges and a reasonable estimate of that change. In addition, the Network Code requires Transco to provide 2 months notice of actual price changes.

Transco is also required under Amended Standard Condition 4 to establish, publish and conform to a charging methodology statement in relation to the provision of transportation services to shippers. Further, under Amended Standard Condition 4A, Transco is obliged to keep its charging methodology under review to ensure it continues to be consistent with a set of relevant methodology objectives - namely that charges should be cost reflective, take account of developments in its transportation business and help facilitate competition between Shippers and Suppliers. Transco is required to consult with Shippers on any change to its charging methodology and furnish Ofgem with a report on the proposed changes together with any representations received from Shippers. If they so wish, Ofgem can issue a direction requiring that the modification is not made, for example if they consider that the modification does not meet the relevant objectives, or that the benefits of the change are outweighed by the cost/complexity they would introduce (e.g. on shipper systems).

The concerns expressed by Shippers through DISG are that under these arrangements independent DNs could unilaterally modify their charging methodologies, or change their charges at different times of year; both increasing costs and complexity faced by Shippers.

### **Dealing with changes to DN charging methodologies**

As under the existing licence arrangements, if an individual DN were to put forward a change to its charging methodology, it would need to consult with Shippers and ensure the preparation of a report for Ofgem detailing the proposals together with any representations received from Shippers. Ofgem would have scope to block the proposal if, in considering the Shipper representations, they considered that the additional costs and complexity imposed on Shippers resulting from a divergence in methodologies were to outweigh the benefits to customers of changing the individual DN methodology. Further, to the extent that a methodology change proposed by a DN were considered to be in the interests of customers and would better meet the relevant objectives, Ofgem might wish to have the scope to require all DNs to consider similar changes consistent with their own obligations, thus maintaining consistency across all DNs. Additionally, each DN might be placed under an obligation to keep its methodology under review in light of other GT methodologies.

In the Agency and Governance RIA, Ofgem proposed that the Governance entity would provide the most appropriate forum for co-ordinating the development of charging methodology changes. In this model, the Governance Entity would provide a secretariat function to enable DNs to put forward charging methodology change proposals for other GTs to consider and to support the administration of any ensuing consultation process i.e. :

- Facilitating meetings to enable GTs to table and progress charging methodology change proposals, handling modification proposals and papers, etc. as directed by GTs and
- Issuing consultations to Shippers on the proposals on behalf of GTs

Under this proposal, individual DNs would make proposals for methodology changes. A consultation would be issued to Shippers on the behalf of the DN; this could be issued on behalf of DNs jointly if that approach were taken. A Charging Methodology Change Report would go to Ofgem on behalf of the DN(s); Ofgem would have the opportunity to block the proposal in the interests of consistency if not all DNs were party to the proposal. It may well be in the interests of DNs to reach a consensus on any methodology change proposal before it is presented to Ofgem. If the proposal is not blocked, the implementation of the new charging methodology would be coordinated by the Governance Entity, with xoserve being required (when instructed by the GTs or their representative) to amend its charging systems and processes accordingly.

These arrangements would not prohibit an innovative DN driving a divergent approach, but Ofgem would need to be convinced that the benefits of the change outweigh the costs and complexity these changes may impose on shippers – or effectively require that other DNs follow suit – before allowing the methodology change to be introduced.

The arrangements would also be predisposed towards a degree of consistency in the first instance since the charge *types* are common by virtue of their definition within the Uniform

Network Code. Initially only proposed changes to unit prices and/or methodology for the purpose of improving the accuracy of revenue recovery (and/or its correct apportionment across charge types) are in scope.

These arrangements could be adapted if they were subsequently found to be inadequate in dealing with methodology changes, perhaps by adding an additional element to the relevant methodology objectives requiring DNs to maintain a degree of consistency with the charging methodologies of other DNs.

#### **Dealing with timing of DN price changes**

Nothing in the GT licence as it currently stands would require DNs to coordinate any changes in prices. However, the individual charging methodologies of the DNs could be adapted in order to tie price changes into specific dates (e.g. 1 January, 1 April, 1 July, 1 October), providing that other licence conditions were made consistent. Individual DNs would then only be able to change their prices on these dates. However, any reduction in flexibility to change prices could potentially conflict with obligations under Special Condition 28A (6) and financial penalties under SpC 28A(8) associated with under- and over-recovery. It would therefore be necessary to relax these licence conditions if the flexibility for DNs to change prices were to be reduced.

#### **Dealing with changes to NTS charging methodologies**

Given the singularity of the NTS and consistent with electricity, it would seem appropriate for NTS charging methodology changes to remain the responsibility of NTS.

#### **Summary of proposals for administration of distribution charging methodologies**

In summary, we propose that the existing regulatory arrangements would encourage DNs to seek consistency when reviewing their charging methodologies, and co-ordinate any charging methodology changes before submitting to Ofgem. The Governance Entity would provide a secretariat function and could be supported by charging experts embedded in the DNs. Common dates for price changes could be embodied into the individual changing methodologies, but this would require a relaxation of some of the revenue recovery conditions in the GT licence.

#### **Invitation for further comment**

In constructing this paper, NGT has endeavoured to take account of input provided so far through the consultation and DISG. NGT would welcome endorsement of the above proposals and/or further comment to assist with the further development of these proposals.

SH 18.6.04