

**Governance in the Electricity Distribution
Commercial Arrangements – Impact
Assessment**

Impact Assessment

May 2005 137/05

Summary

Concerns over the transparency and modification arrangements of the existing rules and obligations for connecting to and using the distribution networks have led to a number of industry work-streams and an Ofgem consultation paper. In response to Ofgem's consultation paper on governance in the Distribution Commercial Arrangements in December 2004¹ the overwhelming majority of respondents were in favour of some consolidation of the existing rules into a single Document having multilateral application in most respects and applying bi-laterally where appropriate. Ofgem anticipates that the Document could include the existing provisions of the Distribution Use of System Agreement (DUoSA), and where appropriate some elements of connection agreements.

The respondents expressed the greatest difference of opinion on the subject of the most appropriate governance mechanism. Some respondents considered that an industry agreement model along the lines of the Master Registration Agreement (MRA) would be appropriate, some favoured retaining the existing arrangements, whilst others agreed with the provisional Ofgem view that a multi-lateral code based on the existing Connection and Use of System Code (CUSC) model would be most appropriate.

This Impact Assessment examines various governance options and sets out Ofgem's minded to view on the most appropriate governance mechanism and its views on the likely impacts of such an approach, although this in no way fetters Ofgem's discretion with regard to the final decision as to which governance model may be adopted. Ofgem invites participants and potential users to consider the appropriateness of proposed governance models and whether connection agreements may be suitable for inclusion in the Document. Although Ofgem requested that respondents to the December consultation document consider the issue of cost, only one attempted to provide a detailed estimate of relevant costs. Ofgem specifically invites responses to this Impact Assessment to consider the likely financial impacts of the various options.

Comments are invited on the issues set out in this document. Responses should be received by Ofgem by 29 June 2005. Ofgem will consider any comments made when formulating its final conclusions. All responses will be published on the Ofgem website and held electronically in the Ofgem Research and Information Centre unless the

respondent makes it clear they would like their response to remain confidential. Respondents are asked if possible to limit any confidential material to appendices in their responses.

Comments should be sent to:

David Edward
Head of Electricity Modifications
Ofgem
9 Millbank
London
SW1P 3GE

Tel: 0207 901 7435
Fax: 0207 901 7451

E-mail: david.edward@ofgem.gov.uk

If you wish to discuss aspects of this Impact Assessment, please contact David Edward, Steve Mackay or Dipen Gadhia on 0207 901 7000.

Table of contents

1. Background.....	4
December 2004 Document	5
Distribution Commercial Forum (DCF) meeting, March 2005	7
2. Objectives	9
The Authority's Objectives	9
Objectives of the policy proposal	10
Consents required	10
3. Options.....	13
Option A. Retaining the current bi-lateral based change management arrangements, but standardising the key documentation.....	14
Option B. The Current Arrangements (Do Nothing)	14
Option C Replacing the current arrangements with a multi-party Code, with bi-lateral application where appropriate.....	14
Option D Replacing the current arrangements with a multiparty agreement.....	18
4. Costs and benefits.....	21
Option A. Retaining the current bi-lateral based change management arrangements, but standardising the key documentation.....	22
Option B Do Nothing Approach.....	23
Option C The Regulated Code – (The Ofgem 'minded to' view)	24
Option D The Industry Agreement Model.....	26
Distributional Effects	28
Financial Costs	29
5. Proposed Next Steps.....	32
Appendix 1	33
Appendix 2 Example text from a current DUoSA for inclusion in a code and subsidiary document to a code	34

1. Background

- 1.1. Since April 2002 a number of workstreams and consultation papers have examined the commercial arrangements applying to the distribution sector. Much of this work has been undertaken under the auspices of the Distribution Commercial Forum (DCF) and has informed Ofgem's thinking in the context of this Impact Assessment. The salient points of this work are explained below,
- 1.2. A number of reasons² emerged as to why change may be needed, these included:
- ◆ the bi-laterally based commercial arrangements are not sufficiently transparent to new market entrants,
 - ◆ a perception of inconsistencies between Distribution Network Operator (DNO) terms, leading to a fragmented approach to market development,
 - ◆ the absence of an effective, robust and transparent change management and consultation process,
 - ◆ no recognised forum for distribution network users to raise commercial issues with GB-wide applicability,
 - ◆ a lack of centralised governance hinders the resolution of issues and disputes common to a class of parties,
 - ◆ the arrangements may not be appropriately focused to allow them to best address the needs of Distributed Generation (DG), and
 - ◆ new licensed electricity distributors and the expected growth in DG have the potential to increase the administrative burden upon industry parties, and could increase to a magnitude where they would pose a threat to the efficient working of the current arrangements.

² These conclusions were drawn from the work of the Distribution Commercial Forum Governance Sub Group. All documentation pertaining to the Group can be found on the Ofgem website www.ofgem.gov.uk under the heading *Ofgem's Work – Electricity Codes*.
Governance in the Electricity Distribution Commercial Arrangements – Impact Assessment
Office of Gas and Electricity Markets

1.3. In addition to evaluating the need for change, the work streams also made an initial assessment of improvements which might be made. It was suggested that the introduction of centralised arrangements, possibly in the form of a regulated code or industry agreement, would:

- ◆ reduce the administrative burden upon participants,
- ◆ encourage solutions to be brought forward,
- ◆ help include the views of all parties,
- ◆ promote costs savings through the existence of a well defined change process,
- ◆ centralise administration costs, and
- ◆ simplify business cost justification.

December 2004 Document

1.4. On 13 December 2004 Ofgem issued a consultation³ seeking stakeholder views about whether the existing disparate rules and obligations should be consolidated into a document and how the document could be implemented.

1.5. The following key questions were identified:

(1) is a document based on a consolidation of the existing rules desirable,

and, if such a document is desirable,

(2) how should the document be developed,

(3) how should the document be implemented, and

(4) who should be bound by the document?

1.6. In summary, Ofgem's provisional view was that:

- (i) a consolidated document is desirable,

³ http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/9586_27604.pdf
Governance in the Electricity Distribution Commercial Arrangements – Impact Assessment
Office of Gas and Electricity Markets

- (ii) it should be developed by industry and approved by Ofgem before being implemented,
 - (iii) the structure, governance and some basic content of the document should be agreed by parties and implemented by a collective licence modification, and
 - (iv) accession to the document should be mandatory for all Distribution Network Operators (DNOs), suppliers, Independent DNOs (IDNOs) (as service providers/receivers) and possibly generators and large connected customers.
- 1.7. The consultation document invited views on a number of features of the potential governance arrangements. Chapter 4 stated the view of the governance sub-group and Ofgem's provisional view.
- 1.8. In addition, Ofgem invited responses from industry on the costs of implementing and administering a new document and, in particular on
- (a) the cost of operating under the current arrangements governing distribution,
 - (b) the costs of implementing and operating the Document, and
 - (c) potential saving (if any) and benefits (if any) associated with using the Document instead of the current arrangements.

Responses to the Consultation

- 1.9. 17 responses were received to the December 2004 consultation document. All but one of the responses considered, to varying extents, that some changes ought to be made to the existing distribution commercial arrangements.
- 1.10. Most respondents considered change was desirable. Comments in support of change suggested that standardisation would be fair and equitable to all users, be more transparent to new entrants, give greater transparency of changes, facilitate competition, provide a reduction in costs, aid the development of DG, reduce the costs and extent of management time currently devoted to the current arrangements, and avoid compounding the burden posed by a growing

number of DUoSAs. In addition it was thought likely that such a change would prevent the patchwork of arrangements currently in force from continuing to frustrate necessary, appropriate, and sometimes mandatory changes required by legislation.

- 1.11. Some respondents recognised a need for change, but offered a more cautious approach commenting that although some change may be needed ‘root and branch reform’ was not justified, or that it may be better to focus on standardisation without creating a new document. One response commented that consolidation should be provided at minimum cost. It also highlighted that the mechanism for the introduction of new subject areas should be clearly defined, and commented on the need to ensure that the costs accruing to smaller players are not disproportionate to the benefits.
- 1.12. The respondent opposed to change was concerned that the problems with the DUoSA had been overstated and considered what it perceived as a low number of determinations referred to Ofgem as evidence of the suitability of the current arrangements. It suggested that the fora already in place had not been used to the fullest possible extent, and cited the costs of the MRA and CUSC models to support its view that the proposed measures would incur unjustifiably high costs.
- 1.13. Parties did not provide extensive detailed comments and examples regarding costs. Of the responses received only one attempted to provide any form of breakdown of costs. Ofgem requests that parties submit further information relating to the costs of managing the current arrangements and the estimated cost of moving to the alternative arrangements proposed.

Distribution Commercial Forum (DCF) meeting, March 2005

- 1.14. Following the close of the December 2004 consultation, the DCF met to hear reports from its sub-groups and a presentation from Ofgem on the next steps in reforming the governance arrangements.
- 1.15. The DG sub-group reported it had concerns relating to the adequacy of the current contractual terms for various types of DG in light of the impending

Generator Distribution Use of System (GDUoS) charging regime. The DCF recognised that whilst there was an imminent need to ensure this issue was addressed (through changes to the current DUoSAs terms), it was equally significant that there was clarity in the final solution. It was suggested this may be best achieved through the introduction of a consolidated document.

- 1.16. In the discussion following Ofgem's presentation some Parties expressed concerns about the proposed scope of the Document and how the content would be agreed. In particular, a concern was expressed over the potential inclusion of connection agreements in a consolidated document. In response to this concern it was noted that whilst it may not be appropriate to include all connection terms in the scope of the initial Document, a degree of standardisation of the legal rules may be of benefit to all parties. Ofgem also invited industry to consider whether it would be appropriate to bring other issues currently outside the scope of the existing DUoSAs within a consolidated Document.
- 1.17. Concerns were also raised about the timescales along which the review of the distribution commercial arrangements and the development of its governance would progress. In response to this, Ofgem has included in Chapter 5 a tentative, but detailed, timescale against which these work streams might be taken forward.

2. Objectives

2.1. In this chapter of the Impact Assessment Ofgem:

- ◆ highlights the key factors the Authority will consider when deciding whether to approve a new consolidated Document,
- ◆ re-affirms the objectives of the policy proposal, and
- ◆ discusses the consents required.

The Authority's Objectives

2.2. The Authority's principal objective and general duties are found in section 3A of the Electricity Act (the Act). The principle objective requires the Authority to protect the interests of consumers by promoting competition between persons engaged in, or in commercial activities connected with, the generation, transmission distribution or supply of electricity.

2.3. It is Ofgem's view that the review of the electricity distribution commercial arrangements impacts upon a number of the general duties contained in section 3A. These include the Authority's duty to carry out its functions in a manner best calculated to promote efficiency and economy on the part of persons authorised by licences or exemptions to transmit, distribute or supply electricity and the efficient use of electricity conveyed in distribution systems, to contribute to the achievement of sustainable development, and its duty to take into account the effect on the environment of activities connected with the generation, transmission, distribution or supply of electricity.

2.4. The Act also requires that, when carrying out these functions, the Authority must have regard to principles under which regulated activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed. The Authority will also take into account its view of best regulatory practice.

Objectives of the policy proposal

- 2.5. Ofgem considers a number of objectives ought to be taken into account in the assessment of any proposed reform, including whether it:
- ◆ facilitates effective competition in the generation, supply and distribution of electricity,
 - ◆ facilitates the efficient, economic and co-ordinated operation of the distribution systems,
 - ◆ enables the efficient discharge of DNO relevant licence obligations,
 - ◆ promotes the efficient discharge of supplier and generator relevant licence obligations,
 - ◆ facilitates the efficient operation of other market participants party to the arrangements developed,
 - ◆ increases the transparency and accountability of the operation of distribution networks,
 - ◆ introduces effective governance and change management arrangements for distribution commercial issues between the stakeholders, and
 - ◆ facilitates enhanced compliance with relevant legislation such as the Renewables Obligation.

Consents required

- 2.6. The consents required to implement these changes are explained below.

Industry Agreement to a Collective Licence Modification (CLM)

- 2.7. In the event the Authority wishes to modify licences by CLM it must give notice in accordance with section 11A(3) of the Electricity Act. Licence holders which are not content with the proposed modification must register their formal objection.

- 2.8. If a sufficient number of statutory objections are received the CLM will be blocked. Numerical tests are used to determine the level of statutory objections required to trigger the blocking-minority thresholds prescribed by the Secretary of State. The thresholds mean that if either 20 percent of relevant licence holders by number, or 20 percent of relevant licence holders weighted by market share, register a statutory objection, the modification cannot (unless it is deregulatory) be made except by successful reference to the Competition Commission.

Authority consent

- 2.9. In order to implement a new consolidated document with a governance framework, a modification to the standard conditions of the Electricity Distribution Licence must be made by the Authority. In determining whether to make any such modification, the key factors which the Authority will have regard to are:
- ◆ its principal objective and general duties as set out in section 3A of the Act and its wider statutory duties, and
 - ◆ the licence obligations of those entities which hold a distribution, generation or supply licence and which will be party to and affected by the proposed governance arrangements.
- 2.10. In coming to a decision on whether to modify the standard licence condition, the Authority will take into account industry respondents' views in response to this Impact Assessment.

Obligations of Distribution Licensees

- 2.11. When deciding whether it would be appropriate to approve a new document consolidating the existing DUoSAs, connection agreements and an associated governance package, the Authority will consider whether the proposed Document will adequately enable distribution licensees to discharge their obligations and whether it offers any additional benefit.

Secretary of State

- 2.12. The Secretary of State must be informed of any intended changes to the Distribution Licence under Section 11A and may direct the Authority not to make any modification to the licence.

3. Options

3.1. This chapter of the Impact Assessment identifies how reform could be implemented. The options are:

- ◆ retaining the current bilaterally based change management arrangements, but standardising the key commercial documentation pertaining to electricity distribution,
- ◆ (do nothing) retaining the current arrangements,
- ◆ replacing the current arrangements with a multi-party code and associated governance, based on consolidation of the existing use of system and some aspects of the connections agreements considered reasonable by parties - in Ofgem's provisional view the appropriate governance mechanism.
- ◆ replacing the current arrangements with a multi-party industry agreement (similar to the MRA) based on consolidation of the existing use of system and some aspects of the connection agreements considered reasonable by parties.

3.2. Although it may not be appropriate to include all connection terms in the scope of the initial Document, industry parties may consider a degree of standardisation of the legal rules may be of benefit to all parties. No suggestions have yet been made by industry as to what these elements might be, and for this reason Ofgem's current view is that only those terms typically found within a DUoSA should form part of a consolidated Document. Ofgem invites industry to suggest which issues currently outside the scope of the DUoSAs, if any, should be brought within a consolidated Document.

3.3. The options identified in this Impact Assessment have been developed to enable Ofgem to conduct a cost/benefit analysis. In developing these options, Ofgem has sought to factor in remedies suggested during discussions and the work of the governance subgroup to the DCF. Respondents should not consider these options as exhaustive. Comments are invited on the high level

structures suggested in this chapter in addition to the merits and demerits including the costs and benefits described in relation to each option.

Option A. Retaining the current bi-lateral based change management arrangements, but standardising the key documentation

- 3.4. As a minimum, the overwhelming majority of respondents to the December 2004 consultation supported options which included standardisation.
- 3.5. Option A retains all the current industry structures and governance mechanisms and seeks to solve the problems identified with the current system by instituting a forum in which the existing rules relating to connecting to and using distribution networks can be standardised.

Option B. The Current Arrangements (Do Nothing)

- 3.6. The current DUoSA arrangements are bilateral agreements between a supplier and distributor and based on a model drawn up in 1998. Either party may instigate change to the DUoSA agreement, although bringing this to fruition depends on mutual agreement between the parties. Around 400 DUoSAs are in place. There is no central governance structure.
- 3.7. Disputes which arise as a result of the operation of the DUoSAs are determined by Ofgem under its powers derived from the Electricity Act.
- 3.8. Following a determination by Ofgem the convention is for other parties to amend their contracts accordingly on the assumption that Ofgem may decide similarly in the event of another dispute on the same type of issue. However, there is no legal obligation on parties to amend their contracts in light of such a determination.

Option C Replacing the current arrangements with a multi-party Code, with bi-lateral application where appropriate

- 3.9. In this option, the starting content of the Code would be based on such consolidation of the existing rules governing connection to and use of the distribution system as parties consider reasonable.
- 3.10. After a number of discussions with industry, and having considered the report of the governance subgroup to the DCF, Ofgem suggests the following proposal as Option C.

Membership, voting, change proposals and funding

- 3.11. The code could be administered under a centralised governance arrangement utilising a Panel of independent experts. That Panel could comprise 1 chairperson, 1 secretary, 9 voting Panel members including 1 energywatch representative. Save for energywatch, the voting Panel members would be elected to the Panel. Panel elections could occur every 2 years. For the purposes of this impact assessment, the elected persons could consist of no more than:
- ◆ 3 DNO-elected experts,
 - ◆ 1 IDNO-elected expert,
 - ◆ 2 supplier-elected experts,
 - ◆ 2 distributed generation-elected experts (one representing expertise on micro-generation, the other on larger scale generation)
- 3.12. NGT could be entitled to attend and speak at meetings but not to vote. Ofgem could have observer status at the Panel.
- 3.13. BSCCo and MRASCo could be invited to attend on an ad-hoc basis by the Panel chairperson.
- 3.14. Decisions taken by the Panel could be based on distribution licence objectives providing clear, objective criteria for decisions. Such objectives could relate to
- (a) the efficient discharge by the licensee of the obligations imposed upon it,
 - (b) facilitating effective competition in the generation and supply of electricity,
 - and (c) facilitating efficiency in the administration and implementation of the arrangements.

3.15. The Panel could be responsible for, amongst other things:

- ◆ administering governance,
- ◆ change management and implementation,
- ◆ developing budgets,
- ◆ contracting of services,
- ◆ considering applications from new parties,
- ◆ checking for default,
- ◆ establishing arrangements for the resolution of operational issues and disputes,
- ◆ determining values of specified parameters, and
- ◆ the grant of derogations in relation to clearly defined operational issues.

3.16. In respect of a regulated code DNOs, IDNOs, and suppliers could be parties to the arrangements. It may be appropriate for some classes to have the option to accede to the Code.

3.17. Any party to the agreement could propose change. In order to be consistent with other industry documents, energywatch could also propose change.

3.18. Ofgem considers that such a code would be funded by DNOs and that this will be taken account of in their allowed revenue.

Specific functions of the Panel

3.19. The other functions of the Panel would include its role in making change:

- ◆ recommendations on issues designated as needing determination solely by or with the consent of the Authority (typically those that have direct impact on competition, the ability of companies to finance their operations, sustainable development or on governance).
- ◆ decisions on other issues.

- 3.20. The way in which the Code format can be split into a primary document and subsidiary documents may help to illustrate which issues the Panel could have a decision making capacity over and where it would make recommendations. In this format, a primary document sets out the obligations which parties must meet, whilst subsidiary documents outline the requirements through which the obligations are discharged.⁴ Two types of subsidiary document are anticipated under this model. The first might be underpinned by a requirement in the primary document, and although it could include more detail than the primary document, could not elaborate on obligations to an extent greater than that envisaged by the primary document. The second could deal with processes where a typical industry approach to an issue exists, but which is not underpinned by a requirement in the primary document.⁵
- 3.21. In the specific context of developing the DUoSAs into a tiered Code, section 8.3 of the model DUoSA which DCF sub groups have begun work to consolidate⁶ may be illustrative of the process of forming a subsidiary document. This example is shown in Appendix 2.
- 3.22. Ofgem anticipates that, if it was considered appropriate to split a code into primary and subsidiary elements, changes to the primary document would be more likely to have a direct impact upon the consumer and would therefore require a final decision by the Authority, following a recommendation by the Panel.

Appeals

- 3.23. In the event that modification decisions on the BSC, CUSC and other agreements are designated as eligible for appeal to the Competition Commission, parties may wish to consider whether these Code decisions should be eligible for appeal. The decision on whether a Code should be

⁴ Subsidiary documents typically define matters such (and amongst other things) the relationship between the parties, detailed methods of meeting obligations, what information should be exchanged between those parties and the timelines along which such information should be exchanged.

⁵ The purpose of the second category would be to ensure the market is accessible to new entrants through the documentation of standard industry processes not mandated under the code.

⁶ This document can be found on the Ofgem website

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/11438_standard_uos.pdf

designated as appropriate for appeal is solely for the Department of Trade and Industry.

Option D Replacing the current arrangements with a multiparty agreement

- 3.24. In this option the starting content of the multiparty agreement could be based upon such consolidation of the existing connection and use of system terms as parties consider reasonable.
- 3.25. In developing this Option D Ofgem has taken into account the report of the governance subgroup to the DCF.

Membership, voting, change proposals and funding

- 3.26. In the multiparty agreement option the governing body (in this case an Executive Committee) could bear a number of similarities to the Panel under Option C in terms of its composition, term of office, and its general responsibilities. The Agreement would also be similar at a general level in relation to its accession requirements, the ability of parties to propose change, and the funding mechanism used. It would also be possible for a multiparty agreement to be split into primary and subsidiary documents, as described in the context of the regulated Code.

Specific functions of an Executive Committee

- 3.27. It is in the context of the specific functions of the Executive Committee where the most significant differences arise between Options C and D. These include:
- ◆ when taking decisions Executive Committee members would represent the interests of the category of party by whom they are appointed according to a pre-determined weighted voting mechanism as appropriate,
 - ◆ the weighting of the votes of Executive Committee members could vary in a pre-determined way according to the subject matter and the affected Parties,

- ◆ the minimum value of approval would be 65% with single companies limited to 20% of the vote,
- ◆ the Executive Committee would be responsible for considering, approving and co-ordinating the implementation of proposals to amend both the primary Agreement (except the alteration of terms requiring the specific consent of the Authority) as well as the subsidiary documents in the Agreement hierarchy,
- ◆ ensuring decisions do not contravene Parties' licence obligations,
- ◆ co-ordinating changes to the Document with other relevant changes in other industry documents, to ensure uniform application of industry policy, and
- ◆ making recommendations to the Authority on behalf of parties to the Agreement in the specific circumstances in which Authority consent would be required.

3.28. Ofgem considers a non-exhaustive list of terms which should not be amended or introduced without the prior written consent of the Authority might include;

- ◆ any term which creates a right of appeal to the Authority,
- ◆ any term governing the constitution and objectives of the Panel,
- ◆ any term governing the procedures of Committee meetings,
- ◆ any term governing Committee member responsibilities,
- ◆ any term governing Committee funding,
- ◆ any term governing recommendations or submissions to the Authority, and
- ◆ any term which requires or permits any matter to be referred to the Authority for approval, consent, direction and decision, or which confers any rights or benefits on the Authority.

Appeals

Executive Committee change management decisions could ultimately be appealed to the Authority. Any party capable of suggesting changes to the Industry Agreement would have a right of appeal. For the avoidance of doubt energywatch would also have a right of appeal.

4. Costs and benefits

- 4.1. This section details the relative merits and demerits of the four options and is split into three parts. The first considers the relative benefits and risks of the various options and takes into account, amongst other things, the impact of the options on competition, security of supply, and the environment. The second section considers distributional effects in the context of how each option affects particular groups, or classes within those groups. The third includes some high level cost estimates, based on the limited comments on this issue received to the December 2004 consultation.
- 4.2. Ofgem has considered each option with a view to determining a number of issues. These include whether each option:
- ◆ is likely to justify the costs involved and relative drawbacks of implementing the proposed solution,
 - ◆ is likely to cause more problems than it solves, and
 - ◆ fits with existing requirements and obligations on those affected.
- 4.3. In the process of carrying out this analysis Ofgem has assessed the merits and demerits including where appropriate the costs and benefits of the counterfactual and the “no change” option and also the merits and demerits of the other options relative to each other.
- 4.4. Ofgem invites comment from industry participants on the perceived benefits of the various options in the context of the paragraphs above.
- 4.5. Appendix A to this document provides a high level summary, in tabular form, of the analysis presented below.

Benefits and Risks

Option A. Retaining the current bi-lateral based change management arrangements, but standardising the key documentation

Benefits

- 4.6. Relative to the current arrangements (Option B), the standardisation element of Option A may facilitate competition by ensuring the application of contract terms on a less discriminatory basis. It also has the benefit of improving the transparency of the arrangements, better enabling potential new entrants to determine the rights and obligations relating to using and connecting to the distribution networks.
- 4.7. Standardising prevailing market terms and ensuring they are equitably applied to all participants may enable the market to operate in a less discriminatory fashion than is the case under the current arrangements.
- 4.8. Relative to the introduction of a Code or an Industry Agreement, (Options C and D) Option A would not increase the regulatory burden on participants; this is particularly true of smaller players and unlicensed players.
- 4.9. In the short term, Option A would be cheaper than the introduction of a Code or Industry Agreement as there would be no need to establish and maintain a new governance mechanism or the secretariat to support it.

Risks and Unintended consequences

- 4.10. If the current arrangements are standardised without any reforms being carried out to the governance mechanism, the benefits of standardisation could be temporary. It is likely that without centralised governance divergences would re-enter the terms of the bilateral contracts and eventually lead to the reappearance of concerns relating to how well the arrangements promote the efficient and co-ordinated operation of the distribution systems. Comments are

invited on whether this perceived defect may be remedied by retaining an informal forum with no obligation on any of the parties to adopt the agreed consolidated document.

- 4.11. Relative to the code and industry agreement model, Option A may prove a less flexible change mechanism and hinder industry's attempts to innovate. This option may also have a negative effect on competition in the sector by failing to accord with principles of good governance in relation to the transparency and inclusivity of the change management mechanism.

Option B Do Nothing Approach

Benefits

- 4.12. Relative to the other options, no resources would be expended on standardisation of the rules or the introduction of a governance mechanism in the short term.
- 4.13. Under a bilateral system each player has only one counterparty which is able to raise change proposals to the contract. Under a multilateral framework, such as a Regulated Code or Industry Agreement, there may be more changes for an individual party to accommodate.
- 4.14. Relative to Option C and D, this option has the merit of not increasing the regulatory burden on small, unlicensed and licence exempt/exemptible parties.

Risks and unintended consequences

- 4.15. In the medium to long term, Option B is likely to increase the administrative and contractual burden on Parties
- 4.16. The current lack of governance and the absence of an efficient change management mechanism makes it difficult for industry to adapt to changes in the distribution arrangements. This is especially pertinent in the context of the anticipated increase in DG, and the prospect of more IDNOs providing services.

- 4.17. Leaving the current mechanism in place may cause additional future costs to arise as a result of changes in the sector driven by anticipated growth in DG and a possible increase in the numbers of IDNOs.
- 4.18. The application of the rights and obligations relating to connecting to and using the distribution networks are not sufficiently transparent to new entrants and lack inclusivity at a general level. In these respects Option B may not sufficiently facilitate competition. Option B may also cause identical classes of party engaged in identical activities to be subjected to different rights and obligations.
- 4.19. Under the current arrangements, the convention is for other parties to alter their agreements following a determination by the Authority on a bi-lateral dispute. However, there is no legal obligation on other parties to do so and the mechanisms for communicating changes to other participants are limited. This may negatively impact competition in the sector, and the efficient and co-ordinated operation of the networks.

Option C The Regulated Code – (The Ofgem ‘minded to’ view)

Benefits

- 4.20. Relative to Options A and B, this option may promote greater transparency by centralising information relating to connecting to and using the distribution networks. The introduction of a Code may also benefit competition by ensuring a standard document is in place as opposed to new entrants having to negotiate bespoke contracts. Reducing barriers to entry on distribution networks could increase the level of distribution connected generation.
- 4.21. The presence of ‘industry standard’ documents under a tiered code, which do not underpin any obligation under the primary document but record an established industry approach to an issue, may particularly benefit new entrants. Splitting the Code in this manner could increase the flexibility of the arrangements and enable industry to develop innovative solutions, without requiring changes to the Code itself.

- 4.22. The inclusion of common connection terms where appropriate in the base content may improve the effectiveness and transparency of the governance arrangements, thus facilitating effective competition in the generation, supply and distribution of electricity. Comments are specifically invited on which aspects of the connection agreements would be most appropriate for inclusion.
- 4.23. Option C may better enable industry to adapt the Code to meet future changes and developments in industry. The governance and change management arrangements offered by Option C may also help licence holders to discharge their obligations by facilitating the resolution of issues between stakeholders.
- 4.24. Option C may enable change to take place in a more transparent and inclusive way, thus facilitating principles of good governance.
- 4.25. Flexible governance in the form of a regulated code may enhance the ability for changes to the rules to apply in a uniform and less discriminatory manner across industry and facilitate competition. This may better enable the efficient discharge of licence obligations relating to non-discrimination.
- 4.26. The Authority currently makes the final decision on proposals to modify the Distribution Code which governs technical aspects of the distribution arrangements. Option C would provide consistency and facilitate cross code co-ordination if proposals to change the commercial arrangements were handled in the same way.
- 4.27. The Authority also currently makes the final decision on modification proposals related to distribution charging methodology. The proposed rule change mechanism of Option C which involves the Authority making decisions on recommendations may allow changes related to the charging methodology to take place in a more co-ordinated fashion, thus enhancing the efficient economic and co-ordinated operation of the distribution system.
- 4.28. Option C may improve the efficiency of the change process by allowing changes to the Code to take place in a structured manner according to defined objectives rather than in a piecemeal fashion.
- 4.29. A higher degree of self determination in terms of decision making may be more appropriate for agreements between suppliers where competition is already

established. However, code-based arrangements (in which Ofgem typically makes the final decision on modification proposals) may be more appropriate for regulating monopoly networks interacting with multiple counterparties.

- 4.30. The flexibility of Option C may be better able to cope with the anticipated increase in micro-generation connections. Additional co-ordination and efficiencies in this area may lead to increased security of supply. A change mechanism consistent with the Authority having regard to its statutory duties could permit fuller evaluation of measures designed to promote security of supply.
- 4.31. A Code drawing on wide ranging expertise for its modifications is likely to be more effective and reduce the contractual burden, especially in administration.

Risks and Unintended consequences

- 4.32. Adoption of this option may result in parties having a greater level of change to accommodate. As a result, there may be an increased regulatory burden.
- 4.33. This option may involve the imposition of licence obligations on parties not customarily subject to this type of obligation. Ofgem invites comment on the extent to which this can be mitigated by making it optional for certain classes to accede to the Code.

Option D The Industry Agreement Model

Benefits

- 4.34. Relative to Option B, the element of this option relating to the standardisation of terms could better facilitate competition by promoting transparency in the arrangements. Option D may also benefit competition by ensuring a pre-existing document is in place as opposed to new entrants having to negotiate bespoke contracts. Reducing barriers to entry to distribution networks may also benefit the environment by encouraging distribution connected generation.
- 4.35. Relative to Options A and B, Option D provides effective mechanisms to allow existing terms to be adapted in the face of changing circumstances.

- 4.36. Relative to Option C, Option D may provide a quicker decision making process as the Authority may not always be required to make a decision on a change proposal.
- 4.37. The flexible governance provided by this Option may better enable industry to adapt the relevant terms to meet future demands of changes and development in industry, thus introducing effective governance and change management arrangements for distribution commercial issues between the stakeholders.
- 4.38. Centralised governance by way of an Industry Agreement may enable change to take place in a more transparent and inclusive way thus introducing effective governance and change management arrangements for the stakeholders.
- 4.39. Centralised governance in the form of an Industry Agreement may ensure changes apply in a uniform manner and thereby facilitate effective competition in the generation, supply and distribution of electricity.
- 4.40. The proposed rule change mechanism may improve the efficiency of the change process by allowing amendments to the rules to take place in a structured way rather than in a piecemeal fashion.
- 4.41. Relative to Options A and B, Option D may be more capable of managing the anticipated growth in micro-generation and the burden this may place on the administrative arrangements. Additional co-ordination and efficiencies in this area may also enhance security of supply. Ofgem invites comment as to the extent to which Option D would deliver this benefit if a licence objective was included requiring the Executive Committee and the relevant evaluation groups to have regard to sustainable development or the environment when arriving at their decisions. Ofgem also invites respondents to consider the propriety of placing a licence obligation on industry participants to take account of such matters.
- 4.42. Relative to Option C, Option D may provide a more expeditious decision making process because not all proposals will go to the Authority for decision. However this has to be tempered by the fact that contentious proposals may still be appealed to the Authority for determination. For the avoidance of doubt, energywatch would have the right of Appeal.

Risks and Unintended consequences

- 4.43. Relative to Option C where the Authority takes change approval decisions and can therefore co-ordinate implementation of consequential or related charging and Distribution Code modifications, Option D poses a risk of divergences developing between those rules. It may also increase the risk of uncoordinated decision making, thus failing to facilitate the efficient, economic and co-ordinated operation of distribution systems.
- 4.44. The ability for decisions to be appealed to Ofgem may introduce an additional element of uncertainty into the decision making timescales.
- 4.45. Relative to Option C Option D may not provide a decision making body capable of taking into account impacts relevant to security of supply.

Distributional Effects

Small Businesses

Option A

- 4.46. Consolidation of the existing rules without reforming the governance may have only a marginal effect on smaller players if there is no consequential obligation on parties to adopt the consolidated document.

Options C and D

- 4.47. Centralised change processes may result in efficiency gains for smaller players. These participants may benefit from improvements to the arrangements suggested by other market participants and assessed by a body representative of a range of commercial interests, without each player having to be involved in every change.

Regulatory burden

- 4.48. Given that the arrangements proposed under Option C and D may be licence based, there is a danger of an increased regulatory burden on smaller, unlicensed or licence exempt participants. This could possibly be mitigated by

making it optional for unlicensed or licence-exempt small players to accede to the document.

Distribution Network Operators

Option A

- 4.49. Implementation of Option A would have a marginal impact on DNOs in terms of distributional effects.

Option C and D

- 4.50. Implementation of C or D may help DNOs to meet their non discrimination objective by obviating instances where (for example) a network operator voluntarily varies the bi-lateral agreement of one counterparty but does not necessarily reflect this in the agreements with other counterparties connected to the same network.

Financial Costs

- 4.51. In the December 04 consultation, Ofgem invited comment from parties on the cost of managing the current arrangements.
- 4.52. Only one respondent attempted to provide an assessment of these costs, which it chose to quantify as savings it would anticipate had the issues it highlighted been dealt with under a multilateral Code or Agreement, as opposed to a number of bilateral agreements. This cost assessment is provided subject to the understanding that many of the benefits associated with introducing the governance outlined above are not amenable to precise quantification.
- 4.53. Table 1 below assumes that for each issue, change is negotiated to all the DUoSAs and when such a change is developed the costs to each counterparty are broadly similar. The table also assumes that each of the 100 market participants⁷ would benefit from a similar saving from those anticipated by the respondent to the December consultation. As such, figures are quoted for the

⁷ There are 43 participants in the domestic and non-domestic supply market and 40 participants in the non-domestic market, of which 3 are site specific. 17 market participants hold distribution licences, of which 3 are IDNOs. For the sake of round numbers this Impact Assessment will assume a maximum of 100 parties. Governance in the Electricity Distribution Commercial Arrangements – Impact Assessment
Office of Gas and Electricity Markets 29 17 May 2005

saving per individual market participant, and the anticipated total saving across the industry for each issue. The total industry savings column indicates the estimated reduced costs which would have accrued on an industry wide basis had the issue been addressed under a multilateral framework with flexible governance, as opposed to the current bilateral system. Ofgem considers the regulated code option or the industry agreement option would be likely to deliver similar savings.

Table 1 Estimated industry savings of addressing 6 issues within a multilateral document as opposed to the current framework

Issue Managed	Individual Party Saving	Total Industry Saving
New DNO's (so far 3)	£9,000	£747,000 ⁸
BETTA changes	£10,000	£1,000,000
NETA	£5,000	£500,000
Utility Act	£5,000	£500,000
RPU ⁹	£10,000	£1,000,000
Standard Connection Agreements	£30,000	£3,000,000

- 4.54. If the change is made to only 25% of agreements, Ofgem anticipates that legal and contract management costs expended on either side of the agreement would reduce by a roughly commensurate amount. This could be expected to lead to a reduction in the total industry savings illustrated in Table 1 in the region of 75%.
- 4.55. The budget for the initial start-up of the CUSC was approximately £350,000, whilst the budget for administering the SPAA arrangements is approximately £340,000 per annum.¹⁰
- 4.56. The cumulative cost savings shown above could indicate that a move toward a multilateral code or agreement would offer significant savings to industry as a whole. It is possible these savings may accrue disproportionately upon suppliers as a group given that the costs of implementing and maintaining the

⁸ Only supplier costs have been accounted for. This figure would be higher if the savings to the iDNO and DNOs contracting with the iDNO are taken into account.

⁹ Revenue Protection Unit.

¹⁰ This figure includes contingency costs and the one-off cost of developing the SPAA website.
Governance in the Electricity Distribution Commercial Arrangements – Impact Assessment
Office of Gas and Electricity Markets

Document would be borne primarily by the DNOs. However, the lower number of DNO participants means the cost savings for each party within that group would be greater than the per-party savings seen by suppliers. When this is taken into account it is possible that significant cost savings will also accrue to DNOs.

- 4.57. Parties are invited to consider the potential cost impact of the options for revising the arrangements described in this Impact Assessment. In particular, Ofgem invites comment as to whether the cost savings accruing specifically to DNOs as a result of moving to a multilateral code or agreement would offset the extra costs of implementing and maintaining such a document. Ofgem's provisional view, (based upon the cost information supplied to date,) suggests these savings would offset any additional costs. Ofgem further considers, if this were to prove not to be the case, that any cost impacts over and above the savings accruing to DNOs would be relatively minor when compared to the increase in transparency, removal of barriers to entry, and other benefits to competition which reform to the current arrangements has the potential to bring about.

5. Proposed Next Steps

- 5.1. Responses to the December 2004 consultation document and comments made in the subsequent industry meetings discussing the review of the electricity distribution commercial arrangements suggested a clear timetable was needed if any agreement developed was to be implemented in line with the timescales suggested by Ofgem and supported by respondents. In response to this, Ofgem considers it appropriate to provide an indication of what the next steps in the development process might be.
- 5.2. There are two strands to the development of this project, the substantive content being developed by industry (a consolidation of DUoSA text) and the governance being consulted on by Ofgem. Ofgem anticipates that these strands would come together during the period between September 2005 and December 2005.
- 5.3. Ofgem anticipates there are a number of key milestones following the publication of this Impact Assessment. One option favoured by industry members is a Collective Licence Modification (CLM), published in the weeks immediately after this Impact Assessment introducing a requirement that a draft Document be developed (exclusive of governance terms) by 1 October 2005. Ofgem have decided not to take this course but early in August 2005, Ofgem intends to publish its conclusions on whether the introduction of governance is appropriate and if so, may invite industry to vote on a CLM requiring the inclusion of governance provisions within a consolidated and final Document. This document will need to be approved by Ofgem by December 2005 in order to introduce a Go Live date of 1 April 2006.

Appendix 1

Table 2 A high level summary of the detail of chapter 4.

Cost/Benefit	Option A	Option B	Option C	Option D
<i>Improving Transparency</i>	✓	✗	✓✓✓	✓✓✓
<i>Regulatory Burden</i>	✓	✓✓	✗✗*	✗✗*
<i>*The burden on licence exempt/exemptible generators may be relieved by making accession optional to these Parties</i>				
<i>Ease for terms to be applied non-discriminatorily</i>	✗✗	✗✗✗	✓✓✓	✓✓✓
<i>Cost to establish</i>	✓	✓✓✓	✗✗	✗✗
<i>Efficiency to manage</i>	✗	✗✗	✓✓	✓✓
<i>Provides long term solution</i>	✗	✗✗✗	✓✓✓	✓✓✓
<i>In accord with the principals of good governance</i>	✗✗	✗✗✗	✓✓✓	✓✓✓
<i>Better in terms of interfaces to manage for the smaller player</i>	✓✓	✓✓	✗✗	✗✗
<i>Capable of adapting to the changing Distributed Generation Environment</i>	✗	✗✗	✓✓✓	✓✓✓
<i>Industry decisions made in a more inclusive manner</i>	✗✗✗	✗✗✗	✓✓✓	✓✓
<i>Capable of co-ordinated change with other relevant Codes & Agreements</i>	✗✗	✗✗	✓✓✓	✓
<i>Provision for greater Regulatory Certainty</i>	✓✓	✓✓	✗✗	✗

Appendix 2 Illustration of treatment of a current DUoSA clause for inclusion in a code and subsidiary document to a code

Example text from a current DUoSA

- 8.3 Within 14 days of the date of an account submitted in accordance with Clause 8.2 the User shall pay to the Company all sums due in respect of such account by electronic transfer of funds to such bank account (located in the United Kingdom) as is specified in the account, quoting the account number against which payment is made and/or such other details as the Company may reasonably require. Subject to Clause 8.4 if any amount remains unpaid after the due date thereof, the Company shall (in addition to other remedies) be entitled to charge interest on the amount unpaid, including interest on any Value Added Tax unpaid, at the rate of 3% per annum above the base lending rate during such period of Barclays Bank plc, compounded annually.

Suggested example text of Primary Code:-

- Within 14 days of the date of an account submitted in accordance with Clause 8.2 the User shall pay to the Company all sums due in respect of such account.
- Subject to Clause 8.4 if any amount remains unpaid after the due date thereof, the Company shall (in addition to other remedies) be entitled to charge interest on the amount unpaid.

Suggested example of text in subsidiary document

- All sums due in respect of accounts shall be paid by electronic transfer of funds to such bank account (located in the United Kingdom) as is specified in the account , quoting the account number against which payment is made and/or such other details as the Company may reasonably require.
- Interest payable on any amount unpaid, including interest on any Value Added Tax unpaid, will be charged at the rate of 3% per annum above the base lending rate during such period of Barclays Bank plc, compounded annually.