

## Code Governance Review: Charging methodology governance options

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**Target audience:** Gas and electricity industry participants, consumer representatives, code administrators and other interested parties.

### Overview:

In June 2008 we released our decision on the scope of the Review of Industry Code Governance (the "Review") and indicated we would consult on whether to make charging methodologies more accessible and subject to change by market participants and customer representatives. The charging methodologies developed by networks have impacts upon both the operational and siting decisions of market players, as well as having significant distributional effects. It is therefore important to consider whether all network users (and customers) should be permitted to raise changes to these methodologies. In this document we evaluate and consult on the principle of whether charging methodologies should be open to change by network users (and customers) and on the options for opening up the charging methodologies. We indicate that there may be advantages to changing the governance arrangements, particularly in terms of improving accessibility and transparency, as well as the accountability of the network owners and operators (the NWOs) for the methodologies. We also note the risks and costs in introducing such a change, including administration costs and pricing volatility risks, and therefore consult on measures that could be used to mitigate them.

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## Context

The Authority is committed to policies and processes that are consistent with better regulation principles and that reduce administrative burden on business while maintaining effective consumer protection.

As part of that commitment, in November 2007 we announced the Review. We considered that such a review was timely given the changes that have occurred in the market, where the nature of participation is changing, particularly for new entrants and smaller players. The Authority's role in relation to code modifications has also changed with the introduction of additional statutory duties and the right of appeal to the Competition Commission.

In June 2008, we set out the scope of the Review and confirmed that a good governance regime should –

- promote inclusive, accessible and effective consultation;
- be governed by processes that are transparent and easily understood;
- be administered in an independent and objective manner;
- provide rigorous high quality analysis of any case for change;
- be cost effective;
- contain rules and processes that are sufficiently flexible to allow for efficient change management; and
- be delivered in a manner that results in a proportionate regulatory burden.

The Review is considering what changes are required to deliver these objectives. The review comprises work strands that look at the delivery of major policy reform and self governance, the role of code administrators, initiatives to support small players, levels of complexity and fragmentation and code objectives.

This consultation considers charging methodologies and the range of options that could make the charging methodology change process more accessible to market participants.

## Associated Documents

- Open letter announcing review of industry code governance - 284/07, November 2007:  
<http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/Open%20letter%20announcing%20governance%20review.pdf>
- Corporate Strategy and Plan 2008 - 2013 - 34/08:  
<http://www.ofgem.gov.uk/About%20us/CorpPlan/Documents1/CORPORATE%20STRATEGY%20AND%20PLAN%2028%20MARCH%202008.pdf>

- Electricity Distribution Licence Review: Conclusions and Statutory Consultation - 50/08, April 2008:  
[http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/DLR%20Conclusions\\_letter.pdf](http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/DLR%20Conclusions_letter.pdf)
- Review of industry code governance - scope of review: 92/08, June 2008:  
<http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/GovRevScope%20-%20MF%20Final%2030%20JUNE%2008.pdf>
- Delivering the electricity distribution structure of charges project: decision on a common methodology for the use of system charges from April 2010, consultation on the methodology to be applied across DNOs and consultation governance arrangements 104/08, July 2008:  
[http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/FINAL%20July%20consultation%20letter\\_22\\_07\\_08.pdf](http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/FINAL%20July%20consultation%20letter_22_07_08.pdf)

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## Summary

The charging methodologies developed by network operators (NWOs) influence short term operational decisions of market players on whether to input/offtake gas and electricity. They also influence long-term infrastructure siting decisions (e.g. for electricity generation stations, gas storage and production facilities and industrial sites). Charging methodologies and the charges they produce can have important distributional effects across different categories of user according to their location on the network. In addition, the charges derived from the methodologies may also have broader environmental impacts, for example to the extent that they can influence the siting decisions of renewable generators.

Under the existing charging methodology governance arrangements, network users and customers are not able to formally propose modifications to the charging methodologies. However, given the multi-lateral impacts of the methodologies on industry participants, there are arguments that industry participants (and customer representatives) should be able to propose changes to the methodologies.

In June 2008 we released our decision on the scope of the Review and made clear that the Authority sees merit in initiating a consultation on whether to make charging subject to change by market participants and customer representatives and the various options for doing so. This document therefore consults on maintaining the status quo and options for change:

- 1. Maintain the status quo.** Under this option the existing arrangements under which only the NWOs can raise changes to the charging methodologies would be retained; though this would not preclude the NWOs from making improvements along the lines of establish best practice.
- 2. Modify the current licence regime.** Under this option, network licences would be modified to enable network users (and customer representatives) to raise modifications to the charging methodologies. The NWOs would be required to assess and consult on these proposals and ultimately submit them to the Authority for decision.
- 3. Industry Code Governance.** Under this option, the charging methodologies would be transferred into the relevant industry codes. Parties to the industry codes would be able to raise changes. The changes would then be assessed by the relevant code panel and submitted to the Authority for decision. Parties would have the ability to appeal Authority decisions on any such modifications to the Competition Commission where the Authority decision diverged from the panel recommendation.
- 4. A new charging methodology change management code.** Under this option a new code would be created containing the rules and procedures by which the charging methodologies of each NWO would be modified (by both NWOs and industry participants). Each NWO would be required to sign up to the code.

### Initial assessment of options

Each of options 2, 3, and 4 in the consultation document is evaluated and assessed by comparison to the status quo (Option 1) using the principles of good governance set out in our June 2008 decision on the scope of the Review.

There may be advantages to changing the governance arrangements, particularly in terms of improving **accessibility and transparency**. There may also be benefits in terms of **accountability**, as NWOs may be required to provide greater rationale for favouring one methodology over suggested alternatives. In particular, opening up the charging methodologies should enable network users and customers to bring forward innovative changes and address deficiencies in the existing methodologies. Indeed, changes might lead to improvements in cost reflectivity which should promote competition between network users, ultimately to the benefit of customers.

Whilst there are important benefits associated with opening up the methodologies, there are also risks and costs. Given the distributional impact of network charges on market participants, there are risks that market participants will raise significant numbers of modification proposals to change the methodologies. In turn, this creates a number of possible effects including **increased change administration costs**, increased regulatory **uncertainty and pricing volatility** risks. These concerns were all identified by respondents in our consultation on the scope of the Review.

In addition, opening up the charging methodologies to change could create increased revenue volatility to the NWO businesses and increase the risks of over/under recovery occurring (and potentially breaches of price control licence conditions

In view of this, we are also consulting on a number of measures that could be used to mitigate potential costs and risks. These include:

- Annual or bi-annual windows for change and implementation with discretion on the Authority to allow proposals to be raised outside of these windows in exceptional circumstances;
- Annual restrictions on the number of changes that can be raised, with discretion on the Authority to allow additional proposals to be raised in exceptional circumstances; and
- Minimum thresholds for network users under which [x] % of a class of users would have to support a proposal before it could be taken forward.

It is important to note that, as part of the Electricity DNO Structure of Charges project, we are currently considering responses to our proposal to establish a new DNO common charging methodology and governance structure by April 2010. Any developments that fall out of the governance proposals set out within the electricity DNO Structure of Charges project will be taken into account in determining the way forward for the Review charging methodology work strand.

It should be noted that whilst this consultation invites views on the principle of making the charging methodologies more accessible and subject to change by network users and customers, we are not proposing to change the basis on which the Authority will decide upon those proposals, which will remain in accordance with relevant objectives (which include for example, cost reflectivity) as set out in the NWOs licence, and with regard to our wider statutory duties.

## 1. Introduction

### Background

1.1. At present, transmission and distribution charging methodologies that are used to derive network charges are governed wholly by gas and electricity NWOs under their licences. In preparing these methodologies NWOs are required amongst other things to ensure that they are cost reflective and secure effective competition.

1.2. These methodologies and the network charges they generate can have major impacts upon the decisions of market participants. In the short term, network charges can impact upon a market participants' willingness or ability to input or off take gas or electricity. In the longer term, the methodologies can influence the siting decisions of electricity generation, gas storage, gas production and industrial facilities. Charging methodologies and the charges they produce can have important distributional effects across different categories of user according to their location on the network. In addition, the charges derived from the methodologies can also have broader environmental impacts to the extent that they influence the siting decisions of renewable generators.

1.3. Under the current governance arrangements there is no ability for market participants to formally propose modifications to the charging methodologies. Instead, market participants can only influence changes in these methodologies through consultation processes undertaken by the NWOs. The ability to influence changes is further limited in electricity distribution as, in contrast to the other NWOs there is no requirement on electricity distribution network operators (DNOs) to consult on any charging proposals.

1.4. This is a matter on which many industry participants have raised concerns, particularly those from the renewable generation sector. Another potential concern is that, in contrast to many of the industry codes that are in place, the governance of many of the charging methodologies is managed by the NWOs themselves rather than through independent entities. This is particularly the case for the arrangements for the electricity transmission and distribution methodologies.

1.5. Therefore, Ofgem is of the view that due to the significant impact charging methodologies have on network users (and customers) there is merit in considering opening up charging methodologies to change by network users and customers. As such Ofgem has proposed a number of options that could facilitate this. Ofgem is therefore seeking industry views and comments on the principle of opening up the charging methodologies to change, and on the options by which this could be achieved.

### The Review scoping decision

1.6. In November 2007, Ofgem launched the Review and issued a consultation on the scope of the Review. In its November Open letter, Ofgem sought views on whether industry participants should be able to propose modifications to the network

charging methodologies and whether they should be incorporated in the industry codes and made subject to industry codes governance.

1.7. The majority of respondents to the November Open letter were in favour of considering this issue in more detail as part of the Review.

1.8. In June 2008, the Authority issued its decision on the scope of the Review. In this decision, the Authority concluded that there is merit in consulting on whether to make the charging methodologies more accessible and subject to change by industry participants and customer representatives

### **Brattle Group report**

1.9. In order to assist the Authority in determining the scope of the Review, Ofgem commissioned an independent report on the industry code governance arrangements and charging methodology governance arrangements. This report was prepared by the Brattle Group ("Brattle"), with legal input from the law firm, Simmons and Simmons. In its report, Brattle explored whether the network charging methodologies should be made subject to the same governance arrangements as those which apply to the industry codes.

1.10. Whilst Brattle recognised that there are advantages associated with bringing charging methodologies into the industry codes, they indicated that there are downsides in terms of regulatory risk for NWOs and increased resource implications for Ofgem and the industry. Brattle therefore did not recommend making the charging methodologies subject to industry codes governance.

### **Existing arrangements and licence requirements**

1.11. NWOs are required by their respective licences to develop and have in place charging methodologies that underpin their Use of System (UoS) and connection charges. These methodologies are accompanied by charging statements which set out the charges levied on users of the networks.

1.12. The licences set out the relevant objectives for the charging methodologies. These vary slightly between gas and electricity and between transmission and distribution, however all NWOs must broadly seek to ensure the following:

- (a) that compliance with the methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by its licence;



- (b) that compliance with the methodology facilitates competition between certain classes of Users and does not restrict, distort, or prevent competition in the transmission or distribution of gas or electricity;
- (c) that compliance with the methodology results in charges which reflect, as far as is reasonably practicable, the costs incurred by the licensee in its network business<sup>1</sup>; and
- (d) that, as far as is reasonably practicable, properly takes account of developments in the licensee's network business.

1.13. A list of the relevant licence conditions with links to the charging methodology objectives in full can be found at Appendix 2.

1.14. The licences also set out the process by which modifications can be made to the methodologies.

1.15. Currently the gas transporter and electricity transmission licences require that the NWOs consult on any modification to the charging methodology. Proposals are subject to a minimum 28 day consultation following which a final report of the proposal is submitted to Ofgem for a decision. National Grid<sup>2</sup> has established the Transmission Charging Methodology Forum (TCMF) to facilitate these requirements from a transmission perspective. The aim of the forum is to provide the means for network users and other interested parties to raise issues they feel worthy of review and provide the opportunity for interested parties to comment on National Grid's proposed modifications to its charging methodologies. There is a similar arrangement in place for the development of gas distribution methodology modifications.

1.16. Following the completion of the consultation process the NWOs then submit where appropriate, a report outlining the proposed modification, how the proposal will promote the relevant objectives, respondents' views and the proposed implementation date.

1.17. Ofgem then has 28 calendar days to decide whether to veto the modification or to issue a notice that it intends to conduct an Impact Assessment. In the event that Ofgem decides to do an Impact Assessment on the proposal then the Authority will have up to a further three (3) months to issue its final decision from the date on which the modification proposal was submitted to Ofgem for decision.

1.18. The electricity DNOs have established a similar forum to discuss modifications to their respective methodologies but, unlike the other NWOs, there is not a licence requirement to consult on proposed changes to the methodologies.

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<sup>1</sup> It should be noted that under the National Grid NTS licence the relevant charging methodology objectives recognise that network charges may be determined via an auction mechanism (Standard Special Condition A5 - Obligations as Regards Charging Methodology).

<sup>2</sup> National Grid is reference to NGET and NGG

## Other related work

1.19. On 22 July 2008, Ofgem issued its decision to create a licence obligation on electricity distribution network owners ("DNOs") to deliver a common charging methodology and sought views on how best to achieve a common methodology across all DNOs and on what form of governance is appropriate for the methodology. This followed a previous consultation issued in April 2008 on the future direction of the structure of distribution use of system charges.

1.20. As part of that consultation, we also set out proposals to establish governance arrangements for the proposed common charging methodology.

1.21. We are currently considering the responses received to that consultation and it is possible that Ofgem may wish to fast track consulting on changes to DNO charging governance arrangements as part of the structure of charges project. Under a fast track approach, a new common charging methodology and governance structure would be in place by April 2010.

1.22. Any developments that fall out of the governance proposals set out within the electricity DNO Structure of Charges project will feed into the work undertaken within the Review.

## Purpose of document

1.23. This consultation sets out a number of issues with the current governance arrangements for the distribution and transmission charging methodologies. This document seeks industry views firstly on the issues associated with opening up charging methodologies to formal change by non-network parties.

1.24. Secondly, this document also sets out and evaluates a number of governance arrangements options for opening up the charging methodologies to which Ofgem is seeking views from interested parties including NWOs, and network users.

1.25. In order to assist respondents, we have also prepared a pro-forma questionnaire to enable respondents to assess the costs to their businesses of the various options set out below. The responses we receive to the cost questionnaire will inform a more detailed Impact Assessment which we will undertake on the options. This pro-forma is included in Appendix 1.

1.26. We would welcome written responses by **Friday 16 January 2009**.

## 2. Key Issues

This chapter will consider some of the key issues that arise when considering changing the charging methodology governance arrangements.

**Question 1:** Are there other key issues that should be considered? If so what impact would these issues have on NWOs and network users?

**Question 2:** Are there any aspects of the key issues that we have not addressed?

**Question 3:** Should Ofgem consider governance arrangements for all charging methodologies on a common timetable, or seek to prioritise? If the latter, which methodologies do you consider should take priority and what would the benefits of this approach be?

2.1. In this chapter we identify a number of key issues associated with opening up the charging methodologies to change by industry participants.

### Accountability and accessibility

2.2. Ofgem is concerned that network users are potentially disadvantaged by the governance processes that underlie the NWOs' charging methodologies as they cannot formally propose changes to the methodologies. The absence of an ability for market participants to propose changes also potentially reduces the accountability of the NWOs for their methodologies and could prevent innovative and pro-competitive changes being made to the methodologies. Given the multi-lateral impacts of the charging methodologies on all network users, there are strong arguments to suggest that similar governance processes to those that apply to the industry codes should also be applied to the governance of methodologies.

2.3. Opening up charging methodologies to change by industry participants could therefore potentially increase the transparency and improve the design of these methodologies with potential consequential benefits to competition and to customers. These benefits are explored further in Chapter 3.

### Increased costs and price volatility

2.4. A number of respondents to the November Open letter noted that should market participants have the power to raise modifications this could lead to large numbers of modifications being brought forward. This could potentially lead to resourcing implications for both the industry and Ofgem. In addition raising numerous proposals could lead to volatility and uncertainty around pricing within the market.

2.5. The risks associated with increased costs and price volatility also raise questions as to whether it would be proportionate to open up the methodologies to change by network users. These issues are discussed further in Chapter 3.

2.6. Ofgem recognises that these are important concerns which need to be considered. Therefore, Ofgem is, along with consulting on the issue, also consulting on a number of measures that could be introduced to mitigate the costs and risks associated with reform of the charging methodology governance arrangements. Possible mitigation measures are discussed in Chapter 3.

## **Network operator revenue recovery**

2.7. NWOs are subject to price controls which are set by Ofgem on a 5 year basis. Under these price controls each NWO has a maximum annual allowed revenue. This allowed revenue is recovered through network charges. Providing market participants with the opportunity to raise modifications could lead to increased risks for NWOs as within year methodology changes may undermine their ability to manage the recovery of their annual revenue allowances. This could in turn impact upon a NWO's ability to ensure that they comply with the requirements of their price control.

2.8. For example, a within year methodology change might result in an over recovery that the NWOs will be penalised for the following year.

2.9. It will therefore be important to consider as part of the consultation process, the nature of any risks to the NWOs and the mechanisms by which such risks might be mitigated.

## **The industry code and charging methodology relevant objectives**

2.10. The relevant objectives against which charging methodologies are judged are different to those for industry code modifications. In particular the charging methodology relevant objectives require that the final charges levied on network users are, as far as reasonably practicable, cost reflective. However the relevant objectives of the industry codes have a requirement to better facilitate the economic and efficient operation of the network.

2.11. We are not proposing to change the basis on which the Authority will decide upon those proposals, which will remain in accordance with relevant objectives (which include for example, cost reflectivity) as set out in the NWOs licence, and with regard to our wider statutory duties.

## **Challenge mechanisms**

2.12. Under the current arrangements, Authority decisions on charging methodology modifications are subject to judicial review. In contrast to code modification decisions, they are not subject to appeal to the Competition Commission.

2.13. If the charging methodologies are transferred into the codes decisions on the methodologies would become subject to code panel recommendations. As a result, under the code modification appeal provisions of the Energy Act 2004 industry participants would be able to appeal an Authority decision on a code modification to the Competition Commission should the Authority, in reaching its decision, overturn a code panel recommendation.

## Approach

2.14. Whilst we consider that the benefits of improving governance apply to all of the charging methodologies, we recognise that the differences which currently exist between transmission and distribution in both the gas and electricity industries may present differing challenges. We note for instance that the licence conditions which underpin the charging methodologies differ between electricity transmission and distribution to a greater degree than in gas. The latter also benefits from the common arrangements provided through the Joint Office of Gas Transporters. Further, we note the NWOs are at differing stages in their respective price controls, which may have a bearing on the appropriate time to implement any new arrangements.

2.15. As such, we would welcome views as to whether it is appropriate to pursue potential changes to the governance arrangements of distribution and transmission in both gas and electricity together, or whether it would be more appropriate to prioritise one or more charging methodologies over others.

## 3. Options

This chapter sets out a number of governance options for charging methodologies.

**Question 1:** Are there alternative governance arrangements that could be considered appropriate for charging methodologies?

**Question 2:** Do you agree with our assessment of the options against the principles of the Review. Are there others impacts that we have not mentioned?

**Question 3:** What are your views on the cost and risk mitigation measures set out in this chapter? Are there other mitigation measures that could be introduced?

3.1. In this Chapter we set out and evaluate a number of options for opening up the charging methodologies to change by industry participants and customer representatives. The options set out below include:

- Option 1 - Maintain status quo
- Option 2 - Modify the current licence regime
- Option 3 - Industry Code Governance
- Option 4 - A new charging methodology change management code

### Option 1 – Maintain status quo

3.2. This option would retain the current arrangements for the governance of the charging methodologies set out within the respective NWOs' licences, effectively maintaining the status quo.

3.3. This option allows the NWOs to maintain control of the number of proposals that are raised and ultimately go forward to Ofgem for decision. The NWOs would also control when these proposals may be implemented.

3.4. Under this option the existing fora established by the NWOs would remain, providing users with an arena to raise issues and to discuss proposals raised by the NWOs. Some respondents to the November 2007 open letter felt that these fora were effective and allowed for good debate on methodology proposals.

3.5. To the extent that the charging methodologies established by NWOs are failing to meet the relevant charging methodology objectives, then the Authority would seek to ensure that the NWOs addressed the deficiencies. If necessary the Authority would be able to take action against the relevant NWO for licence breach if the methodologies do not meet these objectives. Under this framework, if market participants are concerned about deficiencies in the charging methodologies they are able to raise concerns and suggest proposed changes to the relevant NWO. If the NWO does not address these concerns it is open to network users to complain to Ofgem who would consider what action, if any, should be taken.

3.6. In this chapter we do not separately assess the costs and benefits of the "Do nothing" option as it represents the status quo. Instead, and in order to avoid repetition, we compare the costs and benefits of the options for change against the baseline of the "Maintain the status quo" option.

3.7. It should also be noted that there may be incremental improvements that could be made to the charging methodology arrangements whilst preserving the existing regulatory framework. These could include formalising the process under which NWOs could make requests for NWOs to consider changes to the methodologies, and changing practices so that NWOs ensure appropriate attention is given to concerns and requests.

## **Option 2: Modify the current licence regime**

3.8. As we have stated in Chapter 1, the requirement to establish and modify charging methodologies is set out in the licence for NWOs. The licence sets out the objectives that a charging methodology modification must meet and, therefore, the objectives which any modification to a charging methodology must comply with, together with the high level processes that should be followed.

3.9. Under this option we would seek to modify the NWOs' licences to make the procedures and rules more explicit and to enable non-NWOs (including network users and customers) to raise modifications to charging methodologies. Additionally, new rules and obligations will need to be included that would require the NWOs to analyse, assess and consult on the modification proposals. NWOs would also be required to comment upon respondents' views and submit a report on the modification proposal to the Authority with a recommendation. The Authority would then need to decide upon the proposal.

3.10. Although the governance of the methodologies would be retained in the licence, consideration could be given to whether network users and NWOs should have rights of appeal on Authority decisions to the Competition Commission under the Energy Act 2004, and if so, the criteria to be applied in allowing rights of appeal.

3.11. It should be noted that granting any such rights of appeal would require an amendment to the statutory instrument made in accordance with Section 173 of the Energy Act 2004<sup>3</sup> which designates certain documents for those purposes and excludes certain decisions from the scope of the appeals mechanisms. Any such amendments would need to be managed and consulted on by the Department for Business, Enterprise and Regulatory Reform.

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<sup>3</sup> The Electricity and Gas Appeals (Designation and Exclusion) Order 2005

*Initial Assessment against the Review principles*

3.12. **Promotion of inclusive, accessible and effective consultation.** We consider this option would significantly improve the accessibility of the charging methodologies and the methodology change process as it would enable non-network users to raise changes. Whilst the existing arrangements include consultative fora and a requirement on some of the NWOs to consult on charging methodology changes, we consider this option would provide a greater degree of inclusivity and accessibility relative to the status quo as users would have the right to raise changes. In addition, in the case of DNO changes, this option should be a major improvement as it should ensure that all changes are effectively consulted upon, which is not the case under the status quo.

3.13. Further, by increasing inclusivity and accessibility, this option should also improve the accountability of the NWOs over their charging methodologies as it would enable non-network parties to bring forward innovative change and address deficiencies in existing methodologies. We consider that increased accountability should ultimately ensure that the charging methodologies are robust, and transparent. Indeed, improvements in the methodologies that are generated by increased accountability should provide benefits to customers. For example, changes that increase cost reflectivity in charging should promote competition between network users (e.g. electricity generators) and ultimately benefit customers.

3.14. It should also be noted that accountability would be increased further if network users are also given the right to appeal decisions on changes to methodologies to the Competition Commission.

3.15. **Governed by rules and processes that are transparent and easily understood.** In the event that Option 2 was implemented then the rules and processes governing the ability of non-networks to raise changes should be transparent and easily understood. As outlined above, provisions would need to be set out within the NWOs licences governing the methodology change process.

3.16. **Administered in an independent and objective fashion.** Under Option 2, the administration of the charging methodologies would be retained by the NWOs. As such, this option does not differ from the status quo when considered against this principle. Relative to Options 3 and 4, which are discussed below, this option, does not have the benefit of ensuring that the charging methodology change process is administered independently, as the NWOs would retain control of the process. This may in turn create risks in terms of ensuring objectivity in analysis, as NWOs may have vested interests in pursuing certain proposals and outcomes.

3.17. **Rigorous and high quality analysis of the case for and against proposed changes.** We consider that this option should improve analysis of changes as NWOs will be required to treat all change proposals that are raised on an equal basis and ensure that they are subject to thorough assessment before being submitted to the Authority. It should however be noted that, in the absence of fully independent code



administration, there would be risks that the objectivity of the analysis may be compromised.

**3.18. Cost effectiveness.** Option 2 is likely to increase costs associated with charging methodology change management, to the extent that more charging methodology proposals are raised and consulted upon. This may impose additional costs upon NWOs as well as network-users in participating in change processes.

3.19. There are also potential costs for users to the extent that increased charging methodology changes lead to increased volatility in charging with adverse impacts on market participants' contractual positions. Similarly, Option 2 might also increase regulatory uncertainty for market participants to the extent that network charge changes impact upon their contractual positions. In addition, frequent charging changes may reduce the stability and forward looking clarity of network charges which, in turn, may have negative impacts upon infrastructure investment projects that are intending to connect to the gas and electricity networks. As we have noted in Chapter 1, we have included as Appendix 1 a questionnaire for respondents that seeks more information on the potential costs and benefits of these changes. It should also be noted that there may be mitigation measures that could be adopted to reduce the risks of significant numbers of charging proposals being raised.

**3.20. Flexible rules and processes leading to efficient change management.** Option 2 may lead to more efficient change management than the status quo. Under the existing arrangements, significant difficulties have often been experienced in managing changes to charging methodologies. This is particularly the case under the DNO arrangements where limited progress has been made by the DNOs in implementing revised charging methodologies. Indeed, Ofgem has spent considerable resources in recent years both progressing and considering changes to DNO methodologies with limited progress. By enabling non-networks to raise changes, pro-competitive reforms to charging methodologies could be properly debated and considered through an inclusive and transparent change process. This is likely to be more efficient than the status quo.

3.21. Conversely however, it is important to note that there is the risk under Option 2 that opening up the methodologies to change by network users might lead to significant numbers of change proposals and increased administrative burden in the change management process. This might reduce the efficiency of the change process relative to the status quo. As we have noted, there may be measures that could be adopted to mitigate these risks.

**3.22. Proportionate regulatory burden.** The issue of whether to open up charging methodologies to network users raises important questions of proportionality. As noted above there are potentially important accountability and transparency benefits to making the methodologies more accessible and inclusive. These benefits may also translate into improvements in the methodologies leading to consequential benefits to customers. However, such a change will increase the administrative burden on the NWOs to manage the governance process through a potentially increased number of charge changes. Similarly, network users may also face an increased regulatory and commercial burden to the extent that frequent changes in charges

impact upon their commercial positions. However, as noted above, these risks could potentially be mitigated.

3.23. It is also important to consider whether an Option 2 change is proportionate when compared to the status quo arrangements. Ofgem does have powers, in the form of enforcement action<sup>4</sup> under licence, to ensure that the NWOs are ultimately accountable for the methodologies they produce.

3.24. **Other risks and issues.** Another issue which was raised by Brattle's report is that changes to charging methodologies may create revenue risks for NWOs. For example, within year changes to charging methodologies may impact on the level of revenues recovered which may create risks of over or under-recovery against allowed revenues. Again, these risks could potentially be mitigated by the measures we discuss later in this chapter. We would welcome views on the nature and extent of these risks.

### Option 3 – Industry Code Governance

3.25. Under this model the charging methodologies would be transferred into, and made subject to, the governance arrangements of the existing codes. For example, the electricity transmission charging methodologies would be incorporated into the Connection and Use of System Code (CUSC). Similarly, the gas transmission and distribution charging methodologies would be incorporated into the Uniform Network Code (UNC) and the electricity distribution charging methodologies would be incorporated into the Distribution Connection and Use of System Agreement (DCUSA).

3.26. By transferring the methodologies into the codes, they would become subject to the modification processes and rules governing changes to these codes. Change processes to the methodologies would also be administered by the Code Administrator responsible for these codes.

3.27. Charging methodology changes would therefore become subject to Code Panel assessment procedures and Code Panel recommendations. In addition, Authority decisions on charging methodology modification proposals would become appealable to the Competition Commission where these decisions diverged from Panel recommendations.

3.28. Ofgem does not envisage that charging methodology decisions would become subject to any form of self governance arrangements under the codes. This is because the charging methodologies govern the price for access to the networks, with significant consequences for competition. It is therefore important that

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<sup>4</sup> Gas Act 1986, Section 28 and 30A. Electricity Act (1989) Section 25 and 27A

regulatory oversight is maintained in this area. Indeed the Internal Gas Market and Internal Electricity Market Directives provide that third party access tariffs or the methodologies underlying these tariffs should be approved prior to their entry into force by the relevant regulatory authority, namely Ofgem. We would nevertheless welcome comments on this issue.

*Initial assessment against the Review principles*

**3.29. Promotion of inclusive, accessible and effective consultation.** Option 3 should provide similar benefits as Option 2 in terms of increased accessibility and inclusivity. Further, it should also provide similar benefits in terms of increasing the NWO's accountability for their charging methodologies by enabling other parties to formally raise change proposals and have them properly debated and considered. The key difference between Option 2 and Option 3 is that under Option 3, parties affected by the designated industry code or a representative body would be able to challenge Authority decisions to the Competition Commission in circumstances where that decision diverged from the Code Panel recommendation. On this basis, we consider that Option 3 is likely to provide additional accountability benefits when compared to Option 2. In addition, under Option 3, proposals would be subject to code governance and industry panel assessment which is arguably more inclusive than consultations undertaken solely by NWOs (which would be the case under Option 2).

**3.30. Governed by rules and processes that are transparent and easily understood.** A potential benefit of Option 3 is that the charging methodologies would become subject to code modification rules and processes that are well established. This Option would avoid the need to create a new set of consultation rules and processes under the licence which would occur under Option 2. A potential downside is that, whilst well established, the modification rules across the UNC, CUSC and DCUSA differ in significant respects. The fragmentation and complexity of these code arrangements is a concern that Ofgem has separately raised within the broader context of the Review.

3.31. It is possible that the modification rules within the relevant codes (CUSC, UNC and DCUSA) would need to be modified or refined specifically for the charging methodologies. For example, consideration would need to be given to whether "urgency" procedures could be applied to charging methodology code changes.

3.32. To the extent that charging methodologies are governed within the industry codes we are not proposing to change the basis on which the Authority will decide upon those proposals, which will remain in accordance with relevant objectives (which include for example, cost reflectivity) as set out in the NWOs licence, and with regard to our wider statutory duties.

**3.33. Administered in an independent and objective fashion.** We consider that Option 3 should help to ensure that charging methodology change processes are administered in an independent and objective fashion. As such this may provide comfort to users that proposals are being managed impartially and not confined

wholly within the purview of the NWOs as is currently the case. For example, under each of the UNC, CUSC and DCUSA, charge change modification proposals would be subject to Code Panel assessment and governance processes which should help to ensure objectivity. Further, for some of the codes, the charge change process would be administered by an independent code administrator for the code, for example, Electralink, in the case of DCUSA. This would be a significant change from the existing DNO arrangements where the changes are solely administered by the DNOs.

3.34. In the case of the CUSC, the benefits of independence and objectivity would result largely from CUSC Code Panel governance of the change process. Full independence would not however be achieved given that NGET is responsible for the administration of the CUSC.

3.35. In the case of the UNC the benefits of independence and objectivity would be gained by UNC Code panel governance of the change processes. It should be noted that the Joint Office of Gas Transporters, which is responsible for administering and providing secretariat support for the UNC, provides a limited secretariat role in respect of gas transmission and distribution charging methodologies.

**3.36. Rigorous and high quality analysis of the case for and against proposed changes.** Under Option 3 changes would be subject to Code Panel assessment and governance processes as opposed to being the responsibility of NWOs. Whilst Ofgem has raised concerns regarding the quality of analysis performed by Code Panels and administrators as part of the Review, we nevertheless are of the view that subjecting change proposals to industry analysis through the codes process is likely to be more objective relative to the analysis being solely undertaken by NWOs, who may have particular commercial interests in certain outcomes. Conversely however, there is a risk that (at least initially) industry participants and network users will not have the same degree of expertise in the charging methodologies to be able to conduct a rigorous and effective analysis. However, as expertise increases, we would expect this downside to decrease over time.

**3.37. Cost effectiveness.** Option 3 raises similar issues to Option 2 in terms of cost effectiveness. In particular, transferring the charging methodologies into the codes may increase the number of charging changes that are raised and therefore increase administrative and regulatory costs for industry participants. Respondents are invited to fill in the cost questionnaire which is attached as Appendix 1.

**3.38. Flexible rules and processes leading to efficient change management.** We consider that Option 3 should provide largely the same costs and benefits under this principle as Option 2. However, one incremental benefit of Option 3 over and above Option 2 is that it allows charging methodology changes to be coordinated with any consequential code changes that might be triggered. It is often the case that charging methodology changes trigger consequential changes to the industry codes, for example, to introduce new billing and invoicing arrangements for a new charging item. The inclusion of the charging methodologies in the codes should promote greater alignment and coordination in this area which should lead to efficiencies in change management.

3.39. It is important to note that there have been a number of instances where issues have been raised and discussed within the charging methodology forums but not picked up when the consequential code modification was raised leading to issues being re opened. Additionally, due to the requirement for Ofgem to make its decision whether or not to veto a charging methodology or to issue a notice that it intends to conduct an Impact Assessment within 28 calendar days, there have also been instances where code modifications have had to follow the urgency procedure so that the methodology time frame could be met, therefore reducing the industry's time to fully consider the code modification proposal.

3.40. **Proportionate regulatory burden.** We consider that Option 3 raises similar issues of regulatory burden to those already discussed under Option 2.

3.41. **Other risks and issues.** As with Option 2, Option 3 also raises the same revenue risk issues for NWOs.

#### **Option 4 - A new charging methodology change management code**

3.42. Under Option 4, each network charging methodology would be governed by a standard set of modification rules that would be contained within a code. Each NWO would be required under their licences to sign up to the code.

3.43. Whilst each NWO's methodology would be permitted to diverge in content, changes to each of the methodologies would be made following the modification rules and governance procedures set out in the charging methodology code. As with Options 2 and 3, any network user (and also customer representatives) would be able to propose modifications to an NWO's methodology. The relevant NWO would also be able to propose changes to its own methodology.

3.44. This option may require a code administrator or secretariat to administer the charging methodology change and assessment processes. Similarly, an industry assessment panel may need to be established to assess and make recommendations to the Authority on change proposals.

3.45. Further, consideration would need to be given to whether Authority decisions on charging methodologies would become subject to appeals to the Competition Commission under the Energy Act 2004. As with Option 2, this would require changes to the statutory instrument governing appeals or a new statutory instrument. Such a process would need to be managed and consulted on by the Department of Business, Enterprise and Regulatory Reform.

*Initial assessment against Review principles*

3.46. **Promotion of inclusive, accessible and effective consultation.** Option 4 should provide similar benefits to Options 2 and 3 in terms of increased accessibility and inclusivity. Further, it should also provide similar benefits in terms of increasing the NWO's accountability for their charging methodologies. As with Option 2, Option 4 would not provide the same accountability benefits as Option 3, as it would not automatically incorporate a Competition Commission right of appeal (in cases where Authority decisions diverged from code panel recommendations).

3.47. **Governed by rules and processes that are transparent and easily understood.** As with Option 2, a new set of consultation rules and processes would need to be established under Option 4. A potential benefit of Option 4 is that a single set of change processes would apply to all charging methodologies. This is a potential benefit over Option 3 where the methodologies would be transferred into code arrangements that are fragmented and divergent.

3.48. **Administered in an independent and objective fashion.** As with Option 3, we consider that Option 4 provides similar benefits and should help to ensure that charging methodology change processes are administered in an independent and objective fashion by an independent secretariat and industry panel. Indeed, Option 4 may provide additional incremental benefits to Option 3. This is because under Option 3, the administrator of CUSC is also the NWO (namely NGET); whilst under Option 4 the administrator of the charging methodologies code would be independent.

3.49. **Rigorous and high quality analysis of the case for and against proposed changes.** As with Option 3, we consider that Option 4 should improve the quality of analysis of proposed changes. This is because changes would be subject to Code Panel assessment and governance processes as opposed to being the responsibility of NWOs. As with Option 3, an important downside risk is that the independent secretariat responsible for managing the change process may not have the same expertise as the NWOs. This may impact upon the quality of any analysis which is produced. However, as expertise increases, we would expect this downside to decrease over time.

3.50. **Cost effectiveness.** Option 4 raises similar issues to Options 2 and 3 in terms of cost effectiveness as it may increase the number of charging changes that are raised. An additional cost under Option 4 relates to the creation of the new code, panel and secretariat functions. By contrast, Options 2 and 3 would rely largely upon existing code/methodology change processes.

3.51. **Flexible rules and processes leading to efficient change management.** The inclusion of modification rules in a charging methodology code should provide flexibility as the code rules could be changed relatively easily, subject to Authority approval. Whilst Option 4 is likely to be better in this respect than Option 2, it does not have the same benefits as Option 3, which permits methodology changes and commercial changes under the existing codes to be effectively coordinated.

3.52. **Proportionate regulatory burden.** We consider that Option 4 raises similar proportionality issues to those already discussed under Options 2 and 3. The additional issue for Option 4 is whether it would be proportionate to expend resources on creating a new code for charging methodology changes when there are already existing industry code arrangements and processes in place that could be utilised. There would therefore need to be clear additional incremental benefits to justify Option 4.

3.53. **Other risks and issues.** As with Options 2 and 3, Option 4 raises the same revenue risk issues for NWOs.

## Potential Risk Mitigation Measures

3.54. As discussed under the options section above, there are a number of risks and potential costs associated with providing users with the ability to raise charging methodology modifications. To a large extent, whether these risks manifest themselves is dependent on the number of charging methodology change proposals that are raised, should the arrangements be opened up. The risks and costs include:

- increased administration costs;
- revenue risks for NWOs
- volatility and uncertainty in charges for network users.

3.55. In this section we discuss some of the measures that could be introduced to mitigate these costs and risks.

### *Annual or bi-annual windows for change and implementation*

3.56. Under this option, change and implementation windows would be limited (e.g. to once or twice a year) to minimise volatility. Under this approach, a time window could be created which would allow parties to raise proposals that would, if approved, take effect in the following year. This would enable time to be given for proposals to be effectively evaluated and for network users to be provided with sufficient notice of change. These "windows" could be introduced via the codes or the licences. This might help market participants plan their contracting arrangements and reduce uncertainty. It should also assist NWOs in managing their within year revenue risks. Conversely however, there may be risks under this approach that large step changes in charges are introduced on an annual basis. This may have consequent impacts on infrastructure project financing and/or negative impacts on market participants' annual contractual positions depending upon the timing of the window.

3.57. It may be difficult to introduce binding restrictions of this nature and a mechanism would therefore be needed to enable modifications to be raised outside of the window. This mechanism could allow for changes to be made outside the specified windows in certain circumstances against certain pre-specified criteria and only after prior Authority approval.

*Annual Restrictions on numbers of changes*

3.58. Under this option, the number of modifications that can be raised would be restricted in number each year. Such restrictions could be introduced through the codes or the licences. This would have the benefit of minimising administration costs and uncertainty.

3.59. Again, it may be difficult to introduce binding restrictions of this nature and a mechanism would therefore be needed to enable additional modifications to be raised outside the specified window. For example, this could be in certain circumstances and against certain pre-specified criteria, and only after prior Authority approval.

*Modification Proposal Thresholds for Network Users*

3.60. A further mitigating step would be to introduce a threshold regime where a proposal cannot be raised by a network user unless it has met a minimum threshold of support from certain classes of user.

3.61. By way of example, such a rule could apply to gas shippers in the case of gas transmission and distribution charging methodologies. For example, a modification proposal could only be raised where, for example, 40% or 50% of all gas shippers (measured by market share) supported it. Such thresholds would not apply to the NWO in respect of the charging methodology governing its own network.

3.62. It should be noted that there may be downside risks associated with the concept of modification proposal thresholds. In particular, Ofgem would be concerned if the need to achieve a certain threshold prompted an otherwise inappropriate degree of co-operation between network users, potentially distorting competition between such users. This effect would be mitigated to some degree provided the Authority maintained a decision making role over all proposals which were submitted to it.

3.63. *Ofgem would welcome comments from the industry on these suggested mitigating measures.*



## 4. Way forward

4.1. This consultation document considers whether it is necessary to make charging methodologies more accessible and subject to change by industry participants and customer representatives, and the high level options for the future governance arrangements of the network charging methodologies to bring that about.

4.2. We welcome interested parties' views on the issues set out in this document. A sixteen week period has been allowed for this consultation in which we would encourage all interested parties to respond with written submissions. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated in Appendix 1. We would also encourage market participants to respond to the cost questionnaire which we have attached is also included in s Appendix 1.

4.3. We will carefully consider the responses received to the consultation, following which we will publish a further document outlining our initial proposals on whether there should be any changes to the existing arrangements for the governance of the charging methodologies and, if appropriate, what those changes should be. We would expect to publish our initial proposals in Spring 2009.

4.4. It is important to note that, as part of the Electricity DNO Structure of Charges project, we are currently considering responses to our proposal to establish a new DNO common charging methodology and governance structure by April 2010.

4.5. Any developments that fall out of the governance proposals set out within the electricity DNO Structure of Charges project will be taken into account in determining the way forward for the Review charging methodology work strand.

## Appendices

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## Appendix 1 - Consultation Response and Questionnaire

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading, and which are replicated below, and to the cost questionnaire.

1.3. Responses should be received by Friday 16 January 2009 and should be sent to:

- Mark Feather
- Industry Codes and Licensing
- Ofgem
- 9 Millbank
- London
- SW1P 3GE
- 0207 901 7437
- mark.feather@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document(s) to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Next steps: Having considered the responses to this consultation, Ofgem intends to host a workshop for industry parties to discuss their initial views of the governance options. Any questions on this document should, in the first instance, be directed to:

- Jenny Boothe
- Industry Codes and Licensing
- Ofgem
- 9 Millbank
- 0207 901 7122
- jenny.boothe@ofgem.gov.uk

### **CHAPTER: Two**

**Question 1:** Are there other key issues that should be considered? If so what impact would these issues have on NWOs and network users?

**Question 2:** Are there any aspect of the key issues that we have not addressed?

**Question 3:** Should Ofgem consider governance arrangements for all charging methodologies on a common timetable, or seek to prioritise? If the latter, which methodologies do you consider should take priority and what would the benefits of this approach be?

### **CHAPTER: Three**

**Question 1:** Are there alternative governance arrangements that could be considered appropriate for charging methodologies?

**Question 2:** Do you agree with our assessment of the options against the principles of the Review. Are there others impacts that we have not mentioned?

**Question 3:** What are your views on the cost and risk mitigation measures set out in this chapter? Are there other mitigation measures that could be introduced?

## **Cost Questionnaire**

Whilst we consider there would be benefits in aligning the charging methodology governance with the governance principles outlined in Chapter 3, we recognise that any assessment of those benefits will be of a largely qualitative nature. However, in appropriately assessing each of the options for change identified, it will also be important to identify as far as practicable the likely costs of each option. In order to help us gather the relevant information we would welcome responses to the questions below. We would also welcome any other information that would assist us in this assessment.

### **Questions for NWOs**

1. To the extent that non-network parties are able to formally raise modifications to charging methodologies please give an indication of the impact (costs, risks and benefits) on your business in terms of:

- increased number of modifications;
- assessment of additional modifications; and
- regulatory impact.

2. Please give an indication of the costs associated with each of the governance options as set out in Chapter 3 in terms (where appropriate) of:

- administrative costs to assess the additional modifications; and

- administrative costs in managing discussion fora (e.g., Workshops/groups, Panel meetings).

3. Please give an indication of the impact on your business of each of the options as set out in Chapter 3 in relation to:

- price certainty;
- regulatory uncertainty; and
- project investment.

4. Please indicate which of the options poses the least risk to your business activity and why you believe this is the case.

#### **Questions for network users and customers**

5. If you had the ability to raise modifications to charging methodologies how many would you have proposed within the last year?

6. In light of your answer to Question 5, please give an indication (as far as possible) of the costs associated with each of the governance options as set out in Chapter 3 in terms (where appropriate) of:

- developing the proposal(s);
- attending meetings and participating in the change process; and
- the impact on your business in terms of charging price certainty, regulatory uncertainty and business investment.

## Appendix 2 – Licence Obligations relating to charging methodologies

→ This appendix lists the relevant NWO obligations relating to the development and implementation of charging methodologies and associated charging statements.

### Electricity Transmission Licence

1.1. Standard Condition C4: Charges for use of system:

[http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=13436](http://epr.ofgem.gov.uk/document_fetch.php?documentid=13436)

1.2. Standard Condition C5: Use of System charging methodology:

[http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=13437](http://epr.ofgem.gov.uk/document_fetch.php?documentid=13437)

1.3. Standard Condition C6: Connection charging methodology:

[http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=13438](http://epr.ofgem.gov.uk/document_fetch.php?documentid=13438)

### Electricity Distribution Licence

1.4. Standard Condition C13: Charging methodology for Use of system and connection:

[http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=13701](http://epr.ofgem.gov.uk/document_fetch.php?documentid=13701)

### Gas Transporter Licence (NTS)

1.5. Standard Condition 4: Charging of Gas Shippers (general):

[http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=4296](http://epr.ofgem.gov.uk/document_fetch.php?documentid=4296)

1.6. Standard Condition 4A: Obligations as regards to Charging Methodology:

[http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=4297](http://epr.ofgem.gov.uk/document_fetch.php?documentid=4297)

1.7. Standard Condition 4B: Connection Charging Methodology:

[http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=13695](http://epr.ofgem.gov.uk/document_fetch.php?documentid=13695)

### Gas Transporter Licence (DN)

1.8. Standard Condition 4: Charging of Gas Shippers (general):

[http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=4296](http://epr.ofgem.gov.uk/document_fetch.php?documentid=4296)

1.9. Standard Condition 4A: Obligations as regards to Charging Methodology:

[http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=4297](http://epr.ofgem.gov.uk/document_fetch.php?documentid=4297)

1.10. Standard Condition 4B: Connection Charging Methodology:

[http://epr.ofgem.gov.uk/document\\_fetch.php?documentid=13695](http://epr.ofgem.gov.uk/document_fetch.php?documentid=13695)

## Appendix 3 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute for reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority’s powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act 1986 and the Electricity Act 1989 in this Appendix are to Part 1 of each of those Acts.<sup>5</sup>

1.3. Duties and functions relating to gas are set out in the Gas Act 1986 and those relating to electricity are set out in the Electricity Act 1989. This Appendix must be read accordingly<sup>6</sup>.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act 1986 and the Electricity Act 1989 is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must, when carrying out those functions, have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>7</sup>; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.<sup>8</sup>

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<sup>5</sup> Entitled “Gas Supply” and “Electricity Supply” respectively.

<sup>6</sup> However, in exercising a function under the Electricity Act 1989 the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act 1986.

<sup>7</sup> Under the Gas Act 1986 and the Utilities Act 2000, in the case of Gas Act functions, or the Electricity Act 1989, the Utilities Act 2000 and certain parts of the Energy Act 2004 in the case of Electricity Act functions.

<sup>8</sup> The Authority may have regard to other descriptions of consumers.

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed<sup>9</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity;
- contribute to the achievement of sustainable development; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act 1998 to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>10</sup> and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

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<sup>9</sup> Or persons authorised by exemptions to carry on any activity.

<sup>10</sup> Council Regulation (EC) 1/2003



## Appendix 4 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

- Do you have any comments about the overall process that was adopted for this consultation?
- Do you have any comments about the overall tone and content of this consultation document?
- Was this consultation document easy to read and understand, could it have been better written?
- To what extent did this consultation document provide a balanced view?
- To what extent did this consultation document make reasoned recommendations for improvement?
- Please add any further comments?

1.2. Please send your comments to:

**Andrew MacFaul**  
Consultation Co-ordinator  
Ofgem  
9 Millbank  
London  
SW1P 3GE  
andrew.macfaul@ofgem.gov.uk