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16<sup>th</sup> January 2009

Dear Mark

**CODE GOVERNANCE REVIEW: CHARGING METHODOLOGY GOVERNANCE OPTIONS**

British Energy welcomes the opportunity to comment on the issues raised in your consultation paper on the above as published on 17<sup>th</sup> September 2008.

We fully support Ofgem's review of the existing code governance arrangements. The review is timely given that on the whole these arrangements were established some time ago. The core objective of an electricity and gas governance regime should be that it is consistent with the better regulation principles and should therefore be effective, targeted, consistent, proportionate and transparent. With this in mind, we support the objectives of the review as published in June. On the whole, we consider the existing governance regime does satisfy these objectives to a large degree and there is therefore no case for any wholesale or fundamental reform. However, given experience of the arrangements and the changes that have occurred in the market since their establishment, some evolutionary improvements to the existing regime could be developed.

**Headlines:**

- **A case for fundamentally changing charging methodology governance has not been made and the current regime as set out in the network operators' licences should therefore be retained.**
- **The likely risks and costs of giving users the ability to formally raise charging methodology modifications are significant. None of the proposed potential risk mitigation measures appropriately address these issues.**
- **The existing process worked extremely well during the recent TAR process. Moves to formalise this process further should be considered.**

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### The case for change

It would appear that the main argument for change derives from the desire to introduce more transparency and accountability into the development of network owners' charging methodologies. However, we do not consider there to be a significant problem with the existing governance process in this respect particularly in electricity transmission. On the contrary, allowing users to propose changes to the methodologies will introduce significant regulatory risk and cost to all network users and operators. These methodologies have major impacts upon the decisions of market participants (e.g. siting decisions for new plant). Consequently, it is important that there is a stable regulatory environment in respect of transmission/distribution charging arrangements in order to create the right environment for long term investment. A continual review process which not only increases regulatory risk but also introduces greater volatility and costs is particularly damaging to market confidence and does little to improve the perception of market/regulatory risk over the longer term which ultimately is detrimental to the interests of consumers. Given these substantial risks we do not consider that opening up the existing regulatory process to allow users to formally propose changes is a proportionate response to the claimed concerns which only really comprise transparency and accountability.

### Existing arrangements

We do not consider there to be a significant issue with the existing arrangements particularly in respect of electricity transmission and further a robust case for change has not been made. The existing governance process is to a large degree both transparent and accountable. The current formal regulatory process in electricity transmission provides network users with the opportunity to make written representations to National Grid, which are ultimately provided to the Authority, on all proposed changes. In addition, the Authority has a power of veto over all proposed changes. Consequently, National Grid to a degree is already accountable to both network users and the Authority when seeking changes to its charging methodologies.

Over and above the regulatory process, in practice network users are provided with a much greater opportunity to participate in the development of proposals through National Grid's charging forums<sup>1</sup>. Here users are provided the opportunity to debate and influence the development of draft proposals, develop and enhance formal proposals and to put forward possible alternative proposals for National Grid to consider. This process worked extremely well during the development of charging methodology changes arising from the CUSC amendments in respect of the Transmission Access Review (TAR). For instance, network users were provided with the opportunity to participate in the development of draft charging methodology modifications that were required as a consequence of the TAR proposals prior to them becoming formal charging methodology modifications. The TAR working groups were able to explicitly comment on the draft consultation documents before National Grid issued them for wider consultation. Indeed, National Grid was very open to contributions from the industry in all charging debates. We consider the adoption of this albeit 'informal' process greatly increases the transparency, accountability and inclusiveness of the modification process.

Although we support the proposal to preserve the existing regulatory framework it could be enhanced by formalising the practice currently adopted by National Grid as set out above including the process under which network users can request that National Grid consider changes. However, further consideration may be required to assess potential issues that result from the different timescales industry code and charging methodology changes are subject to particularly where there is a direct link between modification proposals that are progressing under the two arrangements.

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<sup>1</sup> TCMF – Transmission Charging Methodologies Forum & CISG – Charging Issues Standing Group

### Potential risk mitigating measures

Unless the risks identified above can be appropriately mitigated consumers interests can only best be protected by maintaining the status quo. Whilst Ofgem has quite rightly explored possible mitigating measures, we do not consider any of the options presented fully address the risks nor are they devoid of potentially inappropriate consequences themselves. Our views on the options presented are:

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

Although change proposals would be restricted to specified time windows we fail to see how this mitigates the risks identified. Within these windows a mass of wide ranging proposals could be presented all of which would need to be assessed potentially within a short timeframe. This potentially could be resource intensive, costly and do little to reduce regulatory risk and the annual volatility of charges.

#### *Annual restrictions on number of changes:*

Restricting the number of modifications that can be raised within a year would be unworkable. The potential effect would be to create a modification race where users would raise modifications as soon as possible in order to ensure that the proposals were considered at the expense of others. This race may have the effect of preventing well defined and beneficial proposals from being developed further purely as a consequence of being timed out. Whilst costs may be contained under this proposal it is clearly not in the interests of network users or customers.

#### *Modification proposal thresholds for network users:*

Whilst we accept in principle this may negate some of the risks identified it would be difficult to implement and may have some unintended negative consequences. When modifications are first formally raised they normally require further development and assessment before users are able to be in a position to fully understand their effect and assess whether they are likely to be consistent with the relevant objectives. Consequently, attempting to obtain an indication of support from network users in advance of the modification being formally raised could be problematic and potentially administratively burdensome. Furthermore, it is unclear to us what an appropriate threshold should be and in particular whether adopting thresholds based on market share with have the effect of marginalising small players within the market.

#### *Alternative Options:*

Notwithstanding our comments above, in the event that a decision is taken to amend the existing arrangements to enable users to formally propose changes to the charging methodologies, the option to transfer the methodologies into industry codes would appear to be the most optimum of the options identified. However, none of the options in this respect are considered better than the current arrangements.

### Summary:

Given the substantial risks that may arise for both users and network operators we do not consider opening up the existing regulatory process to allow users to formally propose changes is a proportionate response to the claimed concerns regarding transparency and accountability. Identified measures to mitigate these risks are not appropriate and indeed may have negative consequences. Therefore, we support the continuation of the existing regulatory framework together with some incremental change to formalise existing operating practices.

If you have any questions regarding this response please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'David Love', with a stylized flourish at the end.

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