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Dear Mark

## **Code Governance Review: Charging Methodology governance options**

Thank you for the opportunity to respond to the consultation regarding the Charging Methodology governance options. This response is on behalf of National Grid Electricity Transmission (NGET) and National Grid Gas (NGG). NGET owns the electricity transmission system in England and Wales and is the GB System Operator. It is responsible for administering the electricity Connection and Use of System Code (CUSC), the Grid Code and the System Operator – Transmission Owner Code (STC). NGG owns and operates the Gas Transmission System and also owns four of the Gas Distribution Networks. In association with the three other gas Distribution Network Operators we also jointly provide for the administration of the Uniform Network Code (UNC) Governance arrangements via the Joint Office of Gas Transporters.

We remain supportive of the current Charging Methodology governance processes, believing that they are robust, transparent, and open to all industry parties. We consider that the strengths and benefits of the current regime have been underestimated.

National Grid remains of the belief that Charging Methodologies should be developed by the network owners with input from network users. Industry forums have been established in both Transmission (Electricity and Gas) and Gas Distribution, where any interested parties can attend to express their views, put forward suggestions and/or voice concerns. Where there is consensus that an issue needs further development, a discussion paper is produced to which industry parties are invited to respond prior to any formal consultation process and subsequent submission to Ofgem.

As highlighted within the consultation document, we believe that providing users with the ability to raise change proposals creates a risk on network operators' ability to efficiently collect revenues. It could also give rise to resource requirement and timing issues, particularly if the volume of Charging Methodology change proposals is increased over and above current levels. In addition it would introduce greater risk for network users in terms of future charging levels and structures, counteracting the desire for greater forecastability of charges.

In summary, we do not believe that fundamental change to the governance of all the Charging Methodologies is required. As an alternative, we suggest that the current, albeit informal, practices are formalised within the relevant Licence conditions or supplementary documents with enhancements and, where appropriate, sharing of best practice across the regimes. However, we do not believe that it would be appropriate to adopt a "one size fits all approach" across all of the current regimes.

We believe that enhancing the status quo in this way is the most cost effective option as all the alternative options identified by Ofgem have the potential to increase costs to the industry. Such costs are likely to be greater than any benefits, given the limited evidence provided on the perceived weaknesses of the current regimes.

We also have reservations about over-complicating the Charging Methodology modification process and, in particular, giving network users and network operators the right of appeal on Authority decisions to the Competition Commission.

A detailed response to the questions raised within the consultation and the cost questionnaire (including our suggested alternative) are attached in the Annexes to this letter. In addition, we are interested to see the responses to the questions and questionnaire from network users, as this may allow us to further clarify the impacts and costs to National Grid of users raising modifications.

If you wish to discuss this further please or have any queries please do not hesitate to contact me, Mark Ripley on 01926 654928, [mark.g.ripley@uk.ngrid.com](mailto:mark.g.ripley@uk.ngrid.com), or Steve Armstrong on 01926 655834 [steve.armstrong@uk.ngrid.com](mailto:steve.armstrong@uk.ngrid.com).

Yours sincerely

*[By e-mail]*

Paul Whittaker  
UK Director of Regulation

## **Annex 1 – Question responses**

### **Key issues**

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

We believe that the key issues identified by Ofgem are appropriate, namely:

- Accountability and accessibility
- Increased costs and price volatility
- Network operators revenue recovery
- The industry code and Charging Methodology relevant objectives
- Challenge mechanisms
- Approach

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

Although we believe the key issues identified are appropriate, we feel that there is limited evidence to quantify any perceived deficiencies with the current regime.

**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?*

We are not convinced of the benefits of making universal changes across all the gas and electricity charging methodologies. As detailed below we believe that there is merit in developing the status quo and adopting incremental improvements which draws on the application of appropriate best practice from all the current regimes.

We also note that Ofgem has already taken action to address the deficiencies of the electricity DNO governance charging methodology and believe that this work should be progressed before changes to other Charging Methodology change processes given the limited evidence of weaknesses in such processes.

### **Options**

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

We believe Ofgem has captured the main options available, namely:

- Maintain status quo
- Modify the current licences regime
- Industry Code Governance
- A new charging methodology change management code

As indicated in our letter, we believe that there is scope for a hybrid option which incorporates two of the main options identified above.

We suggest that the status quo is maintained but the existing informal process for each Charging Methodology is formalised into the appropriate Licence, Licences or supplementary Licence documents.

In addition, appropriate best practice for each Charging Methodology should be introduced with ideas shared across all regimes, for example:

- An annual work plan could be developed with the industry via an annual consultation process.
- Improvements to the consultation process via the standardisation of report documents across all regimes.
- The introduction of an annual review process.

Further ideas and details would need to be developed but we believe that this would be a cost effective and proportionate development which would increase both transparency and accountability of network operators.

Finally, in this hybrid option it is not envisaged that all Charging Methodology processes would be the same but would be adapted to the requirements of that particular regime, its users and network operator(s). To aid understanding of the current processes and the components of this hybrid option, we have set out the existing processes (both informal and formal) in the table in Annex 3 and the timeline in Annex 4.

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

#### Maintain status quo

As indicated in our letter, we consider that the current Charging Methodology governance processes are robust, transparent, open to all industry parties and broadly in line with the assessment criteria for this review. However, we believe that there is scope to provide greater certainty by formalising the existing arrangements with incremental enhancements as previously described.

#### Modify the current licences regime

As stated above, we believe that the current informal processes should be formalised within the relevant Licences or supplementary documents. However, at this stage we do not consider that changes should be made to enable network users to propose modifications to the Charging Methodologies. Providing users with the ability to raise change proposals creates a risk on network operators' ability to efficiently collect revenues. It could also give rise to resource requirement and timing issues, particularly if the volume of Charging Methodology changes proposals is increased over and above the current levels. We also believe that it would introduce greater uncertainty for network users regarding future charging levels and structures.

In addition, we have reservations about over complicating the Charging Methodology process and, in particular, giving network users and network operators the right of appeal on Authority decisions to the Competition Commission (CC). Referring matters to the CC is not something that industry participants (including National Grid) consider lightly and should, in our opinion, be restricted to exceptional circumstances.

Finally, we believe that the benefits of this option in relation to the perceived deficiencies described in the consultation document would not outweigh the costs. Therefore, we do not believe that this option meets the objectives of this review.

#### Industry Code Governance

As stated above, we consider that the cost and disadvantages of allowing network users to propose changes to Charging Methodologies would outweigh any benefit. We believe that the transfer of the methodologies into the commercial codes would be a disproportionate step to resolve the perceived deficiencies in the current regime.

In addition, we envisage that the costs of enabling the same governance process for code modifications to apply to Charging Methodology changes is likely to outweigh the benefits. However if this option is progressed, then greater clarity would be required as to whether the Charging Methodology process would be moved into the codes or some form of ancillary document. The costs between the two options are likely to be quite different given the cost of the legal text required to embed the Charging Methodology processes into the codes. For the above reasons we do not believe that this option meets the objectives of this review.

#### A new charging methodology change management code

Our position on this option is similar to our position on transferring the methodologies into the commercial codes, in that it is disproportionate to the perceived issues and its costs are likely to be significant and will outweigh any benefits.

Ofgem highlights that this option may require the industry to set up a separate code administrator or secretariat to administer the Charging Methodology change and assessment processes, and the establishment of an industry panel (with the expertise to provide views on all Charging Methodologies)

to assess and make recommendations to the Authority on change proposals. This change would seem likely to entail significant costs without providing any meaningful benefit over an above the existing arrangements. For the above reasons we do not believe that this option meets the objectives of this review.

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

We agree with Ofgem that there are a number of risks and potential costs associated with providing users with the ability to raise Charging Methodology modifications. These costs and risks are likely to depend on the number of changes proposed by users but a proportion of the costs will be “sunk” in establishing any new regime. For example, the process of creating a new code administrator will incur cost and this new body will then incur a minimum level of fixed costs (rent, salaries, etc.) each year before any change proposals have been raised. If, as we anticipate, the number of proposed Charging Methodology changes is significant, this would give rise to increases in administration costs, revenue risks for network operators and volatility and uncertainty in charges for networks users.

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

We see some merit in introducing change and implementation windows but believe that they should be limited to once a year in line with the current processes. As previously noted, the current Charging Methodology modification processes already include windows for change and implementation, where network operators evaluate the changes required to the methodology against the relevant objectives, consult with industry participants and implement the revised charging methodology. The timeframes involved are the same each year and by formalising the current processes, we believe that network users can propose development ideas and contribute further during the consultation phase.

#### Annual Restrictions on numbers of changes

We believe that defining the number of changes that can be raised is problematic as many factors, such as industry reform, Exit reform, Transmission Access, European policy etc, drive changes to the Charging Methodologies. In addition, this would open to challenge by any users that are restricted by any such limit. This approach also fails to take in to account the relative importance or the size and scope of any proposals.

#### Modification Proposal Thresholds for Network Users

We do not support the introduction of a minimum support threshold, where users cannot raise proposals unless they have sufficient support from certain classes of user. We agree with Ofgem that this proposal has significant downsides.

## Annex 2 - Cost Questionnaire

We have previously highlighted a number of risks to National Grid (as a network operator) and our response to the questionnaire is focussed on providing a view on the costs (where possible) and/or aims to highlight the cost differences between the four options.

### Questions for NWOs

1. *To the extent that non-network parties are able to formally raise modifications to the charging methodologies please given 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*

The table below gives an indication of the FTEs involved in the development, consultation and implementation of the changing methodologies within National Grid's remit. We have tried to provide an illustration of the potential increase in workload involved in assessing modifications (shown as a % increase) from non-network parties being able to formally raise modifications to the charging methodologies. Given the uncertainty over the number, size, timing and nature of the methodology changes that might be raised, we have used some simple assumptions to help illustrate the potential variation in costs. We have used our current workload (see Annex 5) to aid this assessment and also assumed that there is an acceptable amount of time to analyse and implement any proposals raised.

	<b>Question/charging Methodology</b>	<b>Electricity Transmission</b>	<b>Gas Transmission</b>	<b>Gas Distribution</b>
	Status Quo <sup>1</sup>	6 FTEs	4 FTEs	1.5 FTEs
Example 1	Assessment of additional modifications <ul style="list-style-type: none"> <li>• 1 Window for change</li> <li>• Only NWO proposes a modification</li> </ul>	No change	No change	No change
Example 2	Assessment of additional modifications <ul style="list-style-type: none"> <li>• 1 Window for change</li> <li>• 3 network user proposals received</li> </ul>	40% increase	30% increase	50% increase
Example 3	Assessment of additional modifications <ul style="list-style-type: none"> <li>• Users have unlimited ability to raise modifications</li> <li>• 3 network user proposals received across year</li> </ul>	50% increase	40% increase	60% increase
Example 4	Assessment of additional modifications <ul style="list-style-type: none"> <li>• Users have unlimited ability to raise modifications</li> <li>• 6 network user proposals received across year</li> </ul>	80% increase	60% increase	100% increase

<sup>1</sup> FTE numbers indicated are for those directly involved in the charging methodology processes and exclude indirect resources, including Legal, Finance, Operations, Regulation, xoserve, Joint Office, etc.

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 for a (e.g., Workshops/groups, Panel meetings).

The table below uses the same principles as above to illustrate additional administrative costs for Electricity Transmission only. It should be noted that this excludes costs relating to room hire, catering etc.

We expect the Joint Office will provide details on the administration costs associated with each governance options for both Gas Transmission and Distribution.

	<b>Question/charging Methodology</b>	<b>Electricity Transmission</b>
Example 1	Status Quo	0.5 FTE
Example 2	Administrative costs to assess the additional modifications <ul style="list-style-type: none"> <li>• 1 Window for change</li> <li>• 3 network user proposals received</li> </ul>	20% increase
Example 3	Administrative costs to assess the additional modifications <ul style="list-style-type: none"> <li>• Users have unlimited ability to raise modifications</li> <li>• 3 network user proposals received across year</li> </ul>	20% increase
Example 4	Administrative costs in managing discussion for a (e.g., Workshops/groups, Panel meetings). <ul style="list-style-type: none"> <li>• 1 Window for change</li> <li>• 3 network user proposals received</li> </ul>	10% increase
Example 5	Administrative costs in managing discussion for a (e.g., Workshops/groups, Panel meetings). <ul style="list-style-type: none"> <li>• No Window for change</li> <li>• 3 network user proposals received</li> </ul>	10% increase

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

- Price certainty;
- Regulatory uncertainty; and
- Project investment

We have provided our initial thoughts on the different options above. Within the four broad options there is also scope to define different levels of change and, therefore, it is difficult at this stage to give a definitive answer but we believe that the status quo option provides less price and regulatory uncertainty. The alternative options all have the potential to increase the level of uncertainty (price and regulatory) to the network operators as they facilitate the ability for network users to raise charging methodology modifications but ultimately it will be the number and timing of any such proposals that will set the overall levels.

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

As previously stated, maintaining the status quo poses the least risk to our business.

## Annex 3 Current Working Practice for Charging Methodology changes

### Transmission (Electricity and Gas) and Gas Distribution

I – Informal

F – Formal (a Licence requirement)

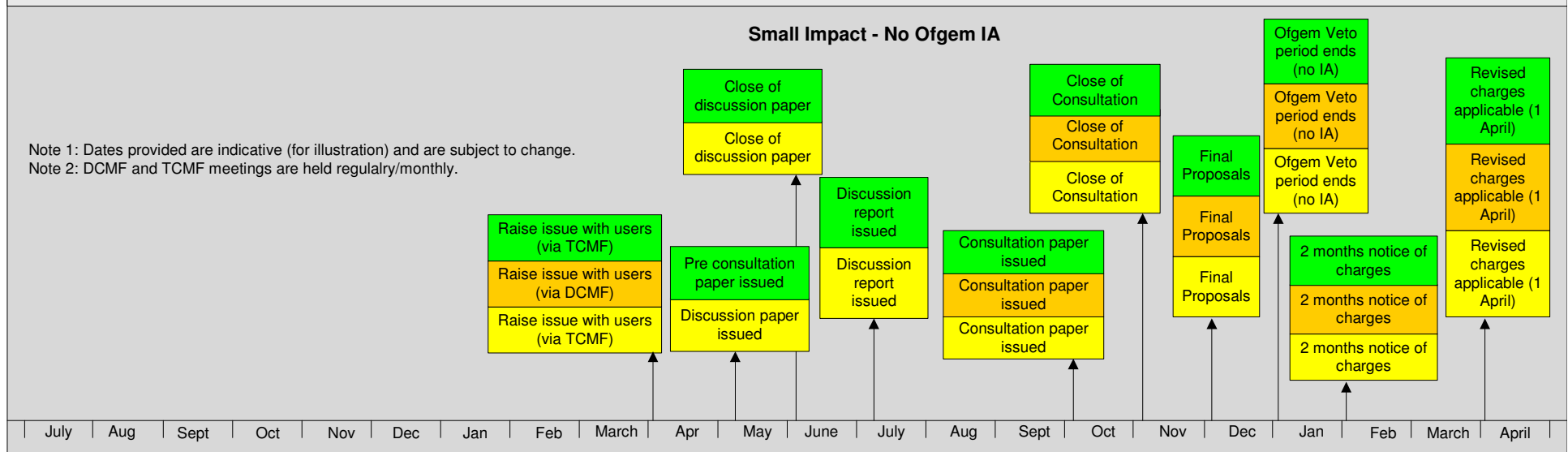
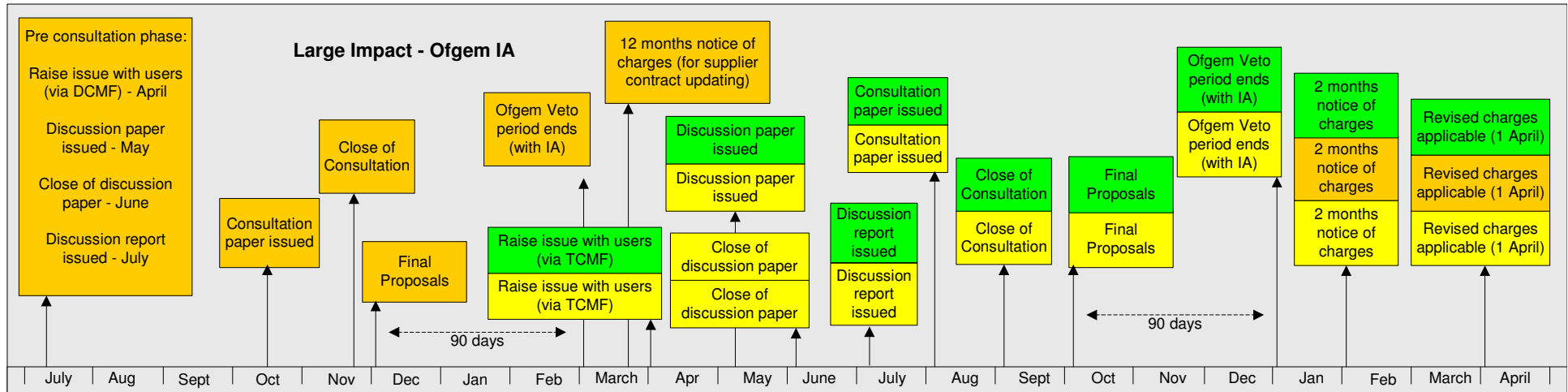
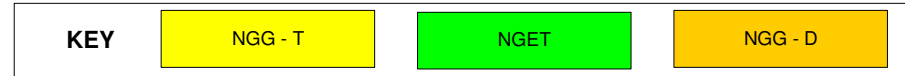
1.	<b>Survey (Gas Transmission only)</b>	I
2.	<p><b>A charging issue is raised.</b> This can happen by various routes:</p> <ul style="list-style-type: none"> <li>– <u>Ofgem</u>: <ul style="list-style-type: none"> <li>e.g. Electricity - Embedded Generation</li> <li>Gas T – Exit Reform</li> <li>Gas D – Modification of Standard Special Condition D11</li> </ul> </li> <li>– <u>National Grid</u>: <ul style="list-style-type: none"> <li>e.g. Electricity – Generation zoning criteria</li> <li>Gas T – TO Over Recovery Mechanism</li> <li>Gas D – Forecasting risk and charging volatility</li> </ul> </li> <li>– <u>Code amendments CUSC and UNC</u> <ul style="list-style-type: none"> <li>e.g. Electricity – Transmission Access CAP161 to CAP166</li> </ul> </li> <li>– <u>Government</u>: <ul style="list-style-type: none"> <li>e.g. Electricity - Offshore Transmission</li> </ul> </li> <li>– <u>Europe</u>: <ul style="list-style-type: none"> <li>e.g. Electricity - Inter-TSO compensation</li> </ul> </li> <li>– <u>User</u>: <ul style="list-style-type: none"> <li>e.g. Electricity - “The New Approach” (remove locational generation tariffs)</li> <li>Gas T – Entry Points with negative LRMCs</li> <li>Gas D- Shipper priorities for methodology changes</li> </ul> </li> </ul>	I



3.	<p><b>Industry discussion forums</b></p> <p>Transmission Charging Methodology Forum - Electricity and Gas</p> <p>Distribution Charging Methodology Forum - Gas</p> <p>Industry and Network Operators can raise and discuss issues at regular meetings</p>	I
4.	<p>Pre-consultation / Discussion papers</p> <p>Undertake a “<b>pre-consultation/discussion</b>” with range of possible options to address the issue.</p> <p>Typically for a 28 day period.</p>	I
5.	<p><b>Discuss</b> responses and any proposed changes at the Industry discussion forums</p>	I
6.	<p><b>Formal consultation</b> on the preferred option. This consultation lasts 28 days.</p>	F
7.	<p><b>Discuss</b> responses and proposed changes Industry discussion forums. Update preferred option if required</p>	I
8.	<p><b>Conclusion Report</b> to the Authority with the preferred option.</p>	F
9.	<p>Ofgem may choose to undertake an <b>impact assessment</b>. If undertaken, this is a 90 day process.</p>	F
10.	<p>Ofgem <b>veto / non-veto</b> after 28 / 90 days after the Conclusion Report has been issued.</p>	F

# Annex 4 – Charging Methodology Consultation Timeline

## Charging Methodology Consultation Timeline



## Annex 5 - Electricity and gas charging issues

### Electricity Charging issues live during 2008

Charging Amendment	Number (Responses)				
	Meetings TCMF / TAR	Pre- Consultation	Formal Consultation	Conclusion Report	Impact Assessment
Charging arrangements for Local Assets (ECM 9, 11)	4 / TAR	1 (9)	2 (25)	2	2
Charging for CEC before TEC (no modification)	2	n/a	n/a	n/a	n/a
Generation Zoning criteria (ECM 10)	3 / TAR	1 (8)	*	*	*
Offshore Transmission (ECM 8)	3	-	2 (10)	Dec 08	*
Long-term fixed price tariffs (ECM 15)	3 / TAR	1 (-)	*	*	*
Capacity auctions (ECM 16)	3 / TAR	1 (-)	*	*	*
Embedded Generation (no modification)	1	*	*	*	*
Over run charging & SO release (ECM 14)	3 / TAR	1 (-)	*	*	*
Charging of the residual (ECM 13)	3 / TAR	1 (-)	*	*	*
ITC (ECM 12)	2+ / TAR	n/a	1 (-)	Dec 08	*
The New Approach (ECM 17)	1	1 (-)	*	*	*
Annual Charging Statement review	-	1 (1)	-	-	-
<b>Total (11 Issues discussed)</b>	-	<b>7</b>	<b>5</b>	<b>2</b>	<b>2</b>

TAR – these charging amendments were typically developed by the Working Groups

\* Modification still being developed with Industry



Entry Points with negative LRMCs (No Mod)	2	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Entry Capacity Discounts and Spare Capacity	2	Discussion to be published after conclusion of Substitution			0	0	0	0	0
Supply and Demand Balancing	1 in 2007/8, 1 in 2008/9	Issue continues into 2008/9 with likely discussion paper and consultation paper							
<b>2007/08 Total (13 Issues discussed)</b>	<b>22</b>	<b>1</b>	<b>1 (13)</b>	<b>2</b>	<b>1 (0)</b>	<b>5 (40)</b>	<b>3</b>	<b>0</b>	

**Gas Distribution Charging issues live during last 12 months (Nov 07 – Nov 08)**

Charging Issue	Number (Responses)				
	Meetings DCMF	Pre-Consultation	Formal Consultation	Conclusion Report	Impact Assessment
DN Entry (DNP03)	-	n/a	1 (1)	1	n/a
System / Customer balance of charges (DNPC04)	2	n/a	1 (13)	1	-
Modification of Standard Special Condition D11 - Move to April price changes from 2009	2	-	-	-	-
Publication of Forecast Revenue and price change information (UNC Mod 186)	4	-	-	-	-
95/5 (DNPC03) implementation - impact on users and embedded storage	2	*	*	*	*
Forecasting Risks & Charging Volatility	1	-	-	-	-
Shipper priorities for methodology changes	2	-	-	-	-
Impact of 2007 AQ Review on income and forecast price changes	1	-	-	-	-
<b>Total (8 Issues discussed)</b>	<b>4</b>	<b>0</b>	<b>2</b>	<b>2</b>	<b>0</b>

\* Consultations and impact assessment was concluded prior to this period.