

Mark Feather
Director, Industry Codes and Licensing
OFGEM
9 Millbank
LONDON
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16 January 2009

Dear Mark,

Ofgem Code Governance Review: Charging methodology governance options consultation.

I am writing in response to the above consultation on behalf of Wales & West Utilities. Please find attached WWU's responses to the individual questions raised which are set out in the order that they appear in the document. We have only responded to the questions to which we feel we can provide informative comments. For clarity we have identified the questions in bold and have set out our answers below each question.

If you have any queries in relation to this response please contact me as below.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'S. Edwards', with a long horizontal flourish extending to the right.

Steve Edwards
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WWU's detailed response to the questions raised in Ofgem Code Governance Review: Charging methodology governance options consultation.

CHAPTER 2 – 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?

All of the key issues have been considered.

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

All aspects of key issues have been 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?

Within the review there is recognition that each sector has its own specific challenges and that each sector does not have the same issues. It is important therefore that solutions from this review are sector specific. If common solutions are implemented to sectors that do not have issues to resolve, there is a risk that future governance may be worse than the existing situation.

The gas distribution sector has a common charging methodology, as required under the Gas Transporter Licence and the Uniform Network Code (UNC) Transportation Principal Document (TPD). Gas distribution network operators (GDNOs) have taken major steps since 2005 to develop a forum open to all industry participants to improve transparency and participation in methodology developments. Through the development and implementation of UNC Modification Proposal 0186 ("*Provision of Cost Information*") the gas distribution sector have successfully introduced a reporting regime that gives the industry longer term indications of charge movements. For these reasons we do not believe that change in the gas distribution sector is either a requirement or a priority.

CHAPTER 3 - OPTIONS

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

For the reasons described earlier we believe the existing governance arrangements for gas distribution are appropriate and change is not required. We have not identified alternative arrangements to those highlighted in the in the review.

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 mentioned?

We do not agree with your assessment of the options against the principles of the review. We detail below our comments. We have not identified any additional impacts to those which are highlighted in the review.

- **Promotion of Inclusive, accessible and effective consultation:**

We believe that implementation of the alternative options 2, 3 & 4 would simply add cost and complexity with no benefit. These alternative options will result in onerous and additional procedures and rules, as well as requiring amendments to statutory instruments and/or placing charging methodology governance within the UNC. From a gas distribution point of view, the existing fora provide an excellent arena for industry participants to raise methodology proposals. The current governance arrangements promote inclusive, accessible and effective consultation processes. We do not see how additional rules and bureaucracy would promote inclusivity or transparency.

- **Governed by rules and processes that are transparent and easily understood.**

As outlined above, the introduction of additional rules within licences, introducing charging methodology governance into the UNC or developing a new regime for charging will simply add more complexity. We do not agree that additional rules will further assist transparency and understanding of gas distribution charging. The GDNOs are working hard through the existing fora to increase understanding of all industry participants and, with the administrative and secretarial support provided by the Joint Office of Gas Transporters, there are clear indications that this framework is working.

- **Administered in an independent and objective fashion.**

It is our view that, within the gas distribution sector, it is only the GDNOs that are independent. All Users have a specific interest linked to their portfolio and geographic location. The GDNO's obligations are clear; namely cost reflectivity and to promote competition. There is no incentive for the GDNOs under the existing regime, where their annual revenue is fixed, to be anything other than independent and objective. We do not see how any of the alternative options could increase independent or objective administration, in fact we believe they would dilute independence and could have adverse distributional impacts. The GDNOs endeavour to ensure that charges are cost reflective and use detailed modelling algorithms to ensure cost reflectivity. We cannot see how any of the alternative options can improve on the current governance arrangements.

- **Rigorous and high quality analysis of the case for and against proposed changes.**

We do not believe that the alternative options would provide a more rigorous and high quality analysis of the case for and against proposed changes. Modification proposals from Users in relation to reporting of charges have highlighted the lack of detailed knowledge in this area that exists within non transportation entities. The Distribution Charging Methodology Forum (DCMF) was established to provide a cost effective mechanism for all industry participants to contribute and learn from all GDNOs in a non confrontational, constructive environment. Participation has been excellent and outputs have been tangible e.g. The Modification Proposal 0186 report (UNC TPD Section V5.13) and 3 successful pricing consultations.

- **Cost effectiveness.**

It is our view, and a conclusion from the Brattle analysis, that the alternative options would add significant unnecessary costs to the industry. From a gas distribution point of view we believe there are no benefits identified to justify these cost increases. We note that the Brattle analysis did not recommend including charging within the UNC.

- **Flexible rules and processes leading to efficient change management.**

We do not believe efficient change management is an issue in gas distribution. Any changes that require amendments to both charging methodology's and to UNC can be, and should remain to be, managed in parallel. This scenario is also prevalent in other areas, for example, licence modifications which, in many cases, require subsequent changes to the UNC. Industry participants are familiar with these challenges and deal appropriately with them.

- **Proportionate regulatory burden.**

We believe the current licence requirements, general legal compliance and current UNC provisions provide the correct proportionate regulatory burden within gas distribution. We do not see how the alternative options will improve accountability and transparency. All of the alternative options would provide additional administration and cost to industry participants. We believe the alternative options would dilute transparency and accountability. Any potential increase in the number of charging methodology modifications could lead to price instability and introduce additional risks to GDNOs of under and over recovery of allowed revenues.

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?

We agree that the alternative options to the status quo give rise to significant risks of increased administration costs, revenue risks for GDNOs and volatility and uncertainty. We believe that the best way to mitigate against these risks for gas distribution is to maintain the status quo and not to implement any of the alternative options.

COST QUESTIONNAIRE

If parties other than GDNOs were able to raise modifications, this would result in a not only a significant amount of time spent on attending meetings to discuss proposed modifications but also on providing analysis to evaluate the proposal and responding to any further reviews required by Ofgem.

It is difficult to estimate with any degree of accuracy the likely cost of this because it would depend on the number as well as the nature and impact of the proposed modifications. However, we would expect it would require us to employ additional resources to cope with the increased workload and on this basis we would estimate the total cost, including travel and administration, to be up to £150k per annum.

In terms of gas distribution, Option 1 – maintaining the status quo poses the least risk, because for a number of reasons as explained above the current regime is working effectively and does not need to be changed.