

Steve Smith  
Managing Director – Networks  
Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE



20 October 2008

Dear Steve

## **COMMON USE OF SYSTEM CHARGING METHODOLOGY**

At the DNOs' meeting with you and Rachel Fletcher on 6 October to discuss positions on Ofgem's proposed collective licence modification, I said that I would write to you separately on behalf of EDF Energy about your intention to retain a non-veto approach to future modifications of the common methodology.

This letter addresses that matter below but, for convenience, also deals briefly with two other issues before doing so.

First, we would like to confirm, for the avoidance of doubt, that EDF Energy will not be entering a statutory objection to the licence modification. It is unfortunate that the overall tone of Ofgem's decision document was unnecessarily polemical, and in some respects both unfair to the DNOs and blind to Ofgem's own contributions to the failings of the past. Nevertheless, we intend to play a full, constructive, and proactive role in the project to prepare and implement a common charging methodology, on time, within a robust and transparent governance and change control framework.

Secondly, you will find in the file attached some recommended minor changes to the text of the draft licence modification issued by Ofgem for the purposes of the section 11A procedure under the Electricity Act 1989. The changes in question are highlighted in yellow for ease of reference.

Almost all of these are consequential changes, in the sense that they arise from the need to maintain consistency with the DLR approach of using one paragraph at a time for one thought at a time, and of substituting 'must' (in line with current statutory drafting technique) for the imperative 'shall'. But there are three material exceptions:

- **Paragraph 13A.13 generally** (at Appendix 1 of SLC 50): assuming that Ofgem insists on retaining the non-veto approach to modifications, we urge you to accept the restructuring of paragraph 13A.13 shown in our file. The purpose of this is to avoid the obscurity that arises from moving from a paragraph header, through a sub-paragraph into four sub-sub-paragraphs, and then out again into a second sub-paragraph – not an easy process for most readers.
- **Paragraph 13A.13(d)** (in our restructuring): paragraph 13A.16 cites two distinct periods of time, so it is sensible to clarify that the period of time in question under paragraph 13A.13(d) is the totality of those two periods.

- **Paragraph 13A.16** (in our restructuring): the four references in this paragraph to the ‘licensees’ are legally ineffective and should be corrected as shown.

We think that you ought to be able to incorporate all of our sensible changes without a statutory re-consultation, on the basis that none of them goes to the substance of any of the provisions of the text on which the current consultation is proceeding.

Turning now to the retention of the non-veto approach, we have previously argued that this is unacceptable from the point of view of regulatory ownership, and should be replaced by a positive approval role in which Ofgem either accepts or rejects proposed modifications (with or without variations) of the common methodology. Ofgem has stated in reply that this would be inappropriate (i) because it has not consulted on the idea of a change, and (ii) because ‘on advice’ Ofgem believes that the current approach sits better with its role as a competition authority.

On the first point, it would have been open to Ofgem to consult on the issue at any time during recent months, as we urged it to do, or even during the section 11A procedure itself. More significantly, we note that, in deciding via this licence modification that parties other than the DNOs themselves should be able to propose modifications to the common charging methodology, Ofgem has pre-empted at least one of the outcomes of its current consultation, running until January next year, on future governance options for network charging methodologies.

The second point is more substantive. We accept that the existence of a common use of system charging methodology for DNOs will, at the margin, have some implications for competitive market operations. However, as both Ofgem’s own decision document and DECC’s recent draft guidance for the Authority make very clear, the introduction of the common methodology is being driven primarily by national energy policy objectives, particularly in relation to investment efficiency and sustainable development.

Accordingly, Ofgem’s role not only in the development and installation of the common methodology, but also in the subsequent monitoring and modification of it, is primarily that of a sectoral regulator acting under the relevant sectoral legislation, and not of a competition authority. Under the non-veto approach, Ofgem has the luxury of being able to have its cake and eat it, since nothing can be implied from its inaction in relation to any specific modification. So the DNOs gain no regulatory justification in relation to the modified methodology, and in that sense are left defenceless, whereas Ofgem itself shares none of that prospective exposure.

In our view, therefore, the balance of the argument lies in favour of embedding a full and positive approval role for the Authority in the modification arrangements.

We hope that this letter is helpful, and we shall be happy to talk these issues through with you in more detail if that would be helpful.

Yours sincerely

**Roger Barnard**

Head of Regulatory Law  
EDF Energy