

9 October 2009

Jenny Boothe
Industry codes and licensing
Ofgem
9 Millbank
London
SW1P 3GE

Dear Ms Boothe

Consumer Focus response to initial proposals on charging methodology governance

Consumer Focus welcomes the opportunity to respond to this consultation.

We agree with the regulator that network charging methodologies are becoming increasingly important in the current market and regulatory environment, impacting to a greater degree on market participants and through them on consumers. We strongly support the notion that users of the networks, consumer representatives and designated parties should be able to influence their development.

This consultation is being held against the background of significant and increasing network investment to be undertaken over the next few years to meet the Government's climate change objectives, including the evolution of smart grids, and to ensure that security of supply is maintained. Decisions about how these augmented networks are charged for affect the way that network users behave, the decisions they make about where to invest in new infrastructure projects and how they hone their competitive strategies in the supply markets. They will also inevitably determine the costs passed through to consumers and affect the prices charged to them.

We believe that there are important benefits to be gained from broadening the range of industry participants in the process of governing charging arrangements and modifying them. We welcome Ofgem's initial impact assessment showing that change could bring about efficiency savings in capital expenditure through the opportunity to elicit a greater variety of proposals. And we agree that wider participation would also facilitate better accessibility to charging development processes, more effective consultation and assessment, transparency and accountability. We therefore support the decision to rule out Option 1, to retain arrangements as they are.

We also support the decision to rule out Option 4, a new charging methodology change management code. On balance we agree that this would add further complexity, fragmentation and unnecessary cost to the current industry governance arrangements.

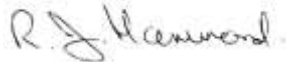
Consequently we consider that either of the two other options for change, Option 2 *refining the existing licence arrangements* or Option 3 *industry codes governance*, would be an appropriate solution and achieve the key goal of due independence from the network operators. On balance we marginally prefer Option 3.

Our reasons for this position of support for Option 3 are set out in more detail in response to the detailed questions below. In summary, however, we believe that this option has advantages in terms of use of existing processes and governance, would see greater accountability and it would facilitate engagement because of better stakeholder familiarity and would allow coordination of charging and code changes.

Although we welcome these initial proposals, it is disappointing that it has taken so long to reach the stage of narrowing the options down to two: the first consultation was initiated as long ago as September 2008. We hope that Ofgem will reach an early conclusion on this issue so that the benefits of participation by service users and consumer representatives can be felt at the earliest possible opportunity, and certainly no later than April 2010.

If you have any questions or would like further information about our response please contact Abigail Hall, Senior Policy Advocate, Regulated Industries Team by telephone on 0207 799 7934 or via email: abigail.hall@consumerfocus.org.uk

Yours sincerely



Robert Hammond
Head of Regulated Industries

Consumer Focus response to questions on charging methodology governance

Chapter 3

Question 1: Do you agree with the output from the assumptions made within the quantitative analysis undertaken?

Yes, the analysis demonstrates that relatively small efficiency savings would be needed in order to outweigh the modest increase costs that have been identified. On a central case of only a £2.5mn (0.06%) reduction of annual capex required if there were 12 additional modification proposals a year over transmission and distribution, the figures strongly support the case for making a change towards wider participation. We believe that it is entirely credible that savings of at least this magnitude could be achieved by generating a greater variety of proposals which reflect thinking across users and consumers. Also the benefits of better governance and engagement are qualitative and cannot always be quantified.

Question 2: Are there any factors that you believe should have been considered in this analysis?

No.

Chapter 4

Question 1: Which governance Option do you consider is the most appropriate for charging methodologies?

We believe that Option 3 industry codes governance would be the best option on balance, although Option 2 refining the existing licence arrangements would also achieve many, although not all, the same benefits.

Under Option 3 the charging methodologies would come under the governance procedures of the relevant industry code. We see a number of advantages to this arrangement. The current industry codes processes are well understood and therefore incorporation of the charging methodologies could be achieved without the need for extensive new processes, albeit we acknowledge that the assessment criteria would be different.

Incorporating charging arrangements into existing code governance structures would allow charging methodologies to be considered alongside the relevant code modifications. This could be a significant advantage particularly on issues which potentially involve major changes, such as the recent proposals on enduring transmission access arrangements. Reviewing the charging options at the same time as the modification proposals can allow a more complete and rounded view of the implications.

A further benefit is that this route would open the possibility, subject to meeting the relevant criteria, of decisions made by Ofgem being capable of appeal to the Competition Commission. We consider that this would improve the accountability of decisions.

We also believe that making the change process independent of the network operators should give comfort that the process is fully objective and that assessment processes would be better balanced.

The regulator has already decided that the forthcoming common methodology for distribution charging will be governed under the DCUSA. Adopting different arrangements for transmission and gas distribution would tend to further fragment industry processes and complicate industry governance.

Question 2: Do you agree that we should initially focus on gas and electricity transmission charges, with gas distribution potentially to follow as a second phase?

No. We do not consider that an adequate reason has been provided for why gas distribution should be excluded at this stage. Ofgem points out that given reform of the governance charging arrangements for electricity distribution is going ahead separately, focussing on transmission arrangements would mean that gas distribution charging methodologies would be the only one (apart from the independent networks) which would not be subject to change proposals. The argument that significant levels of investment activity means that reform of the transmission arrangements should be treated as a priority relative to distribution is not an adequate argument for ignoring the gas distribution arrangements. Therefore we consider that they should be included, as the same arguments for potential quantitative and qualitative benefits apply.

Question 3: Do you agree that annual/biannual change and implementation windows are the most appropriate mitigation measures to progress going forward for all the options?

Yes. We recognise the danger of creating instability and possible volatility in pricing should a number of modifications be introduced and then implemented in rapid succession. This would add to the overall risks to participants of operating in both the wholesale and retail markets and affect prices to consumers as a consequence. But we also believe it is important that the processes adopted should facilitate proposals coming forward and being properly considered.

We welcome that Ofgem has decided to reject the idea of restricting the number of proposals that may be raised in a year or to require a threshold level of support. We support the proposal for time windows when changes can be proposed. Our preference would be for biannual windows, rather than an annual window, for raising modification proposals. We agree that a fixed change window will help targeting of resources to help rationalise multiple modifications that are tackling the same issue.

Question 4: Do you consider a 3 or 4 month window to be sufficient time to consider modification proposals? Please indicate your preference for either 3 or 4 months.

We prefer 4 months: although many proposals may be completed within 3 months, the option of a 4 month period would provide additional flexibility.

Question 5: Do you agree with our approach to defining “affected parties” who would be entitled to raise modification proposals?

The proposals appear sensible. We note that Option 3 appears to provide more flexibility as Ofgem will be able to direct the parties that are able to raise proposal, whereas under Option 2 affected parties will need to be specifically defined within the licence drafting process.