

# **CMG SUBMISSION (15.07.09) TO OFGEM**

## **Governance and Change Control Arrangements for the DNO Distribution Charging Methodologies**

### **A. Introduction**

1. This paper and the recommendations it contains have been developed by the Common Methodology Group, acting on behalf of the DNOs as a whole, and in accordance with the requirements of standard condition 50 of the electricity distribution licence.

2. The paper sets out the DNOs' proposals relating to the governance and change control arrangements for the HV/LV common distribution charging methodology ('the CDCM') that is currently being evolved by the CMG for implementation next April 2010. The key recommendation of the DNOs in this respect is that the CDCM should be incorporated into the Distribution Connection and Use of System Agreement ('DCUSA') and hence be subjected to the governance and change control mechanisms of that document.

### **B. Background to the current position**

3. It should be explained at the outset that, as Ofgem knows, the DNOs' proposals were in fact developed by them in advance of the implementation of SLC 50 into the distribution licence. However, in undertaking their work, the DNOs decided to act as if SLC 50 were in force within the licence and they were bound by its requirements for the development of governance and change control arrangements, including its provisions requiring DNOs to consult with other interested industry parties.

4. Following the conclusion of that earlier development and consultation process, the DNOs have further considered their proposals, in particular in the light of Ofgem's stated intention that the DNOs should be required by further licence modifications to develop common EHV distribution charging methodologies ('the EDCMs') for implementation with effect from April 2011. As a result, the DNOs have concluded that:

- There is no case for creating different arrangements between one category and another, so their proposal to use the DCUSA as a vehicle for governance and change control purposes should apply equally (subject to any necessary adaptations) to the arrangements for both the CDCM and the EDCMs.
- Both Ofgem's requirement for the DNOs to develop and implement EDCMs, and the DNOs' proposal that these should be incorporated (along with the CDCM) into the DCUSA for change control purposes, would best be achieved by means of a single set of licence modifications later this year.

5. Accordingly, and at Ofgem's request, this paper is supported by a number of draft legal attachments that reflect the DNOs' further conclusions. These attachments contain illustrative legal text that is designed to provide for: (a) the appropriate development and implementation of the EDCMs, (b) the legal incorporation of both the CDCM and the EDCMs (on different dates) into the DCUSA, and (c) the DCUSA modifications that would be necessary in order to give full effect to those incorporations.

### **C. Key requirements for governance and change control**

6. The starting point for the DNOs is that an appropriate governance and change control framework for the CDCM must conform to the core requirements for governance and change control set out in SLC 50. These are found mainly in Part F of the condition, and are then incorporated into new SLC 13A on an enduring basis from next April.

7. In considering the nature of that framework, the DNOs thought that they should also take account of Ofgem's ongoing Code Governance Review, in particular in relation to any options presented there for the governance and change control of transmission and distribution network charging methodologies to be incorporated into the existing core industry documents, such as the DCUSA.

8. SLC 50 requires the DNOs to prepare arrangements, to be approved by the Authority, for the governance and change control of the CDCM. The arrangements required from the DNOs must provide for six main elements:

- Provision for Distribution Services Providers (i.e. the DNOs) and other interested parties to meet regularly to review the CDCM.
- Provision for both the DNOs and parties other than the DNOs to raise modification proposals.
- Provision for formal receipt of and consultation on modification proposals.
- Provision for modification reports to be prepared in a formal process for submission to the Authority.
- Provision for review of the modification arrangements themselves.
- Provision for ensuring publication of the up-to-date methodology.

9. Both the CDCM as implemented and all subsequent modifications of it are required to meet (or better meet) the objectives set out in SLC 50 (such as facilitating competition and cost-reflective charging). Those objectives are similar to, but more clearly drafted than, the former SLC 13 objectives which they now replace. An appropriate governance and change control framework will need to enable the CDCM objectives to be better achieved on a continuing basis.

### **D. DCUSA's governance and change control mechanisms**

10. The current change mechanisms for the DCUSA bear a number of close similarities with the features set out above, but they are not identical. The DNOs therefore carried out a cross-check of the requirements for governance and change control set out in SLC 50 against the DCUSA mechanisms, and identified which elements of the latter would need to be flexed to reflect the core elements of SLC 50.

11. The results of this analysis are shown in the table at Appendix 1. They indicate that direct analogues for the core elements of SLC 50 do exist within the DCUSA in almost all key respects. There is only one real exception to this revealed consistency. It relates to the requirement imposed by SLC 50 for (a) all authorised electricity operators, and (b) any other persons whose interests are materially affected by the CDCM, to be able to propose modifications and have them processed.

**12.** The SLC 50 requirement would therefore allow not only DNOs, IDNOs, and licensed suppliers to raise modifications and participate in the modification process, but also (for example) exempt suppliers, all generators, and other persons such as major end users. But the latter parties currently have no formal role within DCUSA, and hence no direct ability or right to participate in the DCUSA modification process.

**13.** If the DCUSA arrangements were applied to the CDCM for governance and change control purposes, this difficulty could be resolved in most circumstances on an informal basis via the use of existing clause 10.2.4 of the DCUSA. This allows a change proposal to be raised by any person or body that might be designated by Ofgem for that purpose.

**14.** Alternatively, the DCUSA could be modified so that materially affected persons can formally raise modifications, though only in respect of the CDCM. The DNOs would favour this option, as this should put the matter beyond any possible doubt.

### **E. Incorporation of the CDCM into the DCUSA**

**15.** Having considered all of the points brought forward above, the DNOs believe that applying the DCUSA's current and well-established arrangements to the CDCM (with any necessary adaptations) from its implementation date is likely to be the best and certainly the most convenient way of implementing a governance and change control framework for the CDCM on an enduring basis that is fully consistent with the core requirements of SLC 50.

**16.** The DNOs believe that their key proposal has the following substantial merits:

- The DCUSA provides existing change control and governance arrangements that almost entirely meet the core requirements for the arrangements set out within SLC 50.
- The very tight timetable under SLC 50 for the implementation of the CDCM does not allow for the creation *de novo* of a fresh suite of governance and change control arrangements.
- The resource and expense of creating a new suite of governance and change control arrangements cannot be justified.
- As the DCUSA has been designated by government for the purposes of the Energy Act 2004 appeals regime, Ofgem's decisions concerning future modifications of the CDCM will automatically be subject to a merits-based appeals mechanism.

**17.** The last point is particularly important, given Ofgem's (in some respects justifiable) desire for a greater degree of regulatory jurisdiction over industry code processes where the drivers for change are public policy issues. In the absence of merits-based appeals under the Energy Act, the only available means of challenging Ofgem's modification decisions in relation to the CDCM would be by way of judicial review.

**18.** However, the process of judicial review is essentially concerned with the improper exercise of public administrative power. It is not a process suited to evaluating and determining the merits of technically complex regulatory decisions. The Energy Act appeals regime, on the other hand, is designed precisely for that purpose.

## **F. Ofgem's review of industry code governance**

19. In making their key recommendation, the DNOs have had regard to the governance options (apart from Option 1, the maintenance of the status quo) canvassed by Ofgem in its Code Review consultation paper of September 2008 about the governance of network charging methodologies. The DNOs acknowledge that as Ofgem has not yet published any decisions in respect of that consultation, their thinking has been unable to be guided by an understanding of the Authority's conclusions.

20. However, at this stage in the DNOs' development of the CDCM, where time is of the essence, the DNOs can see little merit in the development of either Option 2 (which would involve modifying the current generic licensing regime for industry codes) or Option 4 (which would require the introduction of a wholly new charging methodology change management code, probably with its own free-standing secretariat and panel arrangements to administer the modification and assessment processes).

21. The DNOs' proposals are therefore consistent with Option 3 in Ofgem's paper, in which network charging methodologies would be transferred into, and made subject to, the governance and change control arrangements of existing industry codes. In the CDCM context, there is no point in trying to re-invent the wheel. The DNOs believe that the formal incorporation of the CDCM into the DCUSA would, in the round, best satisfy the review criteria identified in Ofgem's paper of September 2008, while also delivering the core governance requirements of SLC 50 for the CDCM.

## **G. Matters arising from the DNOs' consultation process**

22. The DNOs' proposals, including illustrative drafting of the licence modifications necessary to make them work, were presented to the Distribution Charging Methodology Forum ('the DCMF') at its meeting held on 3 April 2009. Membership of the DCMF (about 80 participants altogether) comprises all the DNOs, some IDNOs, major supplier and generator representatives, some economic consultants, and members of Ofgem's policy staff. The proposals generated much discussion and were well received.

23. The proposals were then issued to DCMF members and other interested parties for a period of formal consultation. This lasted for a month. No adverse comments were received, and when the proposals were re-presented at the next DCMF meeting held on 4 June, the only outstanding issue calling for discussion was why licence modifications would be needed to bring the CDCM under the existing governance and change control arrangements of the DCUSA. That point echoed a question raised by Ofgem separately from the consultation process, namely whether it really is the case that further licence modifications are required to achieve that end.

24. The DNOs believe that such modifications will definitely be required to give effect to the incorporation of the CDCM into the DCUSA and its subjection to the DCUSA's existing change control mechanisms. The reasoning for this is set out in more detail in legal advice that they have supplied to Ofgem, but (in brief) the correct position is that without appropriate further licence modifications:

- The inclusion of the CDCM in the DCUSA would be *ultra vires* because the scope of the DCUSA is limited to the matters referred to in SLC 22 and does not currently extend to charging methodologies.

- Even if the permitted scope of the DCUSA could be interpreted to include charging methodologies, a conflict would nevertheless arise (particularly in respect of the applicable objectives) between the licence requirements applying to the DCUSA under SLC 22 and the licence requirements that will apply to the CDCM on an enduring basis under new SLC 13A.

25. In essence, therefore, the DCUSA cannot lawfully be used as a vehicle (as Ofgem had at one time suggested) to achieve the substance of the DNOs' proposals by allowing CDCM modification proposals to be processed under the DCUSA change procedures without further licence modifications. A new standard licence condition will be needed to ensure that the CDCM is brought properly within the scope of the matters for which the DCUSA must make provision.

26. In addition, since the applicable objectives against which CDCM modifications are to be assessed are similar, but not identical, to the objectives that are applied to DCUSA modifications, the new licence condition will need, in effect, to disapply the latter and apply the former for the purposes of dealing with CDCM modifications.

## H. Summary and review of draft legal attachments

27. As noted above, in the light of their earlier development work, observations arising from the consultation process, and Ofgem's current policy intentions in respect of the development of EDCMs, the DNOs have concluded that:

- Their proposal to locate the CDCM in the DCUSA for governance and change control purposes should apply equally, with any necessary adaptations, to the governance and change control arrangements for the EDCMs. There is no case for applying different arrangements to different categories of charging methodology, and it is logical to locate all of the categories within the same legal instrument for governance and change control purposes.
- Both Ofgem's requirement for the DNOs to develop and implement EDCMs, and the DNOs' proposal that these should be incorporated (along with the CDCM) into DCUSA's change control mechanisms, would best be achieved by means of a single set of licence modifications later this year. It is desirable to avoid having to revisit the licence repeatedly to modify or add standard conditions in relation to charging methodologies.

28. The three attachments (in separate files) that accompany this paper contain the legal drafting that the DNOs believe would be necessary to give full and complete effect to the above conclusions (which are clearly inter-related). In detail:

- **Attachment 1:** This is a new SLC 50A that is designed to require the DNOs to develop EDCMs for implementation with effect from April 2011. It is modelled on the SLC 50 / 13A approach to the CDCM project, and contains a prospective new SLC 13B that kicks in for enduring purposes on 1 April 2011. Its practical effect is that each of the two possible EDCMs would be developed collaboratively, for common purposes, by those who are party to it (so that those DNOs that decide to choose LRIC develop LRIC together, and those DNOs that decide to choose FCP develop FCP together).

- Following the DNOs' recent discussions with Ofgem, SLC 50A defines the boundary for the EHV charging regime as the mirror image of the boundary defined in SLC 50 for HV/LV purposes. SLC 50A also assumes that the only thing that is now needed to complete the Authority's initial specification of the core principles and assumptions for the EDCMs is Ofgem's finished exposition of the FCP methodology (which is promised to be imminent).
- This new standard condition applies only to the DNOs and would have effect in the licence from 1 October 2009, reflecting the lengthy lead-time that is likely to be required for the EHV project.
- **Attachment 2:** This is a new SLC 22A, which would supplement the existing SLC 22 in the licence. SLC 22A is designed to provide for the incorporation of the CDCM and the EDCMs into the DCUSA (but on different incorporation dates) under the same licence condition. In particular, it secures the legal incorporation of the charging methodologies into the DCUSA as matters for which the DCUSA is required to make provision, requires the objectives for modifying the charging methodologies to be those specified in this condition rather than those specified for DCUSA modifications, and prohibits (until April 2015) any modification proposals designed to wholly or partly replace one charging methodology with another charging methodology.
- This new standard condition would apply to all distributors, because one of its paragraphs puts all distribution licensees under a duty to ensure that all of the DCUSA modifications necessary to give effect to the incorporation of the charging methodologies are achieved in good time. Like SLC 50A (see above), it would have effect in the licence from 1 October 2009.
- **Attachment 3:** This is the current version of the DCUSA, as modified by the Secretary of State last month for offshore transmission purposes, showing the amendments of the DCUSA that would be needed to reflect and give effect to the incorporation of all three charging methodologies in conformity with the requirements of proposed new SLC 22A. The changes are flagged in yellow in the DCUSA text and are unlikely to be contentious despite their occasional complexity. All modifications of the charging methodologies are reserved as Part 1 Matters, falling within Ofgem's exclusive jurisdiction.
- Because of the size of the DCUSA, the pages affected by the amendments are identified now as: last contents page, and pages 9, 18, 23, 46, 47, 53, 79, 81, 84, 86, 88, 101, 102, 103, 104, 105, 338, 339, and 340.

## I. Request for Authority's view

29. The Common Methodology Group, acting on behalf of all of the DNOs, commends these proposals to Ofgem. The DNOs would welcome the earliest possible indication of the Authority's view, so that all appropriate further steps can be taken to ensure that a robust governance and change control framework for the charging methodologies is established in a timely manner.

**Appendix 1: Core Governance and Change Control  
Requirements of SLC 50**

<b>Condition Number</b>	<b>Particular Core Requirement</b>	<b>DCUSA Analogue</b>
50.25	DNOs to meet periodically with AEOs and other affected persons to discuss further development of the CDCM	Clauses 5.3.7 and 5.4.5
50.26	Receipt of change proposals, consultation with DNOs, AEOs and other affected persons, and evaluation	Clauses 10.3 and 11.14 (but a stronger 11.14.1 would be included)
50.27	Report on change proposal	Clause 11.20
50.28	Review and future modification of modification arrangements	Clause 5.3.7 and Section 1C generally
13A.3	Implement and comply with the CDCM	DNOs obliged to comply with DCUSA
13A.4	Review the CDCM against objectives at least once every year	A new sub-clause within Clause 5.3 would be included
13A.5 to 13A.10	Objectives of the CDCM	A new Clause 3.2 would be included to state the CDCM objectives separately from the DCUSA objectives
13A.11	AEOs and materially affected persons may raise change proposals	Clause 10.2.4 would be amended to reflect the DNOs' proposal at paragraph 14 of the main paper
13A.13	Same as 50.26 above	Clause 11.20
13A.14	Modify the CDCM as directed by Authority	Clause 14
13A.16	Assumption in the event that the Authority does not respond within 28 days	No current analogue (but Clause 13 would be amended to reflect this requirement)

<b>Condition Number</b>	<b>Particular Core Requirement</b>	<b>DCUSA Analogue</b>
13A.17	Publication of the CDCM	Clause 5.3.11
13A.18	Derogations	Clause 56

**Note:** the DCUSA modifications arising from this table of comparisons, and such other modifications as would be required to reflect and give effect to the incorporation of all of the common charging methodologies into the DCUSA, as recommended by the DNOs, are shown in Attachment 3, which accompanies this paper as a separate file.