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Dear Jenny

Code Governance Review: Governance of Charging Methodologies – Initial Proposals

Thank you for the opportunity to respond to the August consultation on Ofgem's Initial Proposals for the Governance of Charging Methodologies. This response is on behalf of National Grid Electricity Transmission plc (NGET) and National Grid Gas plc (NGG). NGET owns the electricity transmission system in England and Wales and is the National Electricity Transmission 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 and operates four of the gas Distribution Networks. In association with the three other gas Distribution Network Operators it also jointly provides for the administration of the Uniform Network Code (UNC) Governance arrangements through the Joint Office of Gas Transporters.

National Grid remains of the view that the current Charging Methodology governance process can be enhanced and formalised in such a way as to facilitate the objectives of the review whilst providing an equitable balance between accessibility for network users and the introduction of additional costs and risks to the industry. The current methodologies have functioned extremely well to date and indeed there have been numerous changes to enhance and develop them over recent years with full participation from network users. We do not believe that fundamental change is required; however, we recognise Ofgem's position and the views of many respondents who felt that more fundamental change is necessary.

The cost benefit analysis undertaken appears to demonstrate that the costs of administering any of the options on an enduring basis could be outweighed by the assumed benefits. We note that the change implementation costs and additional burden placed on the Authority were not factored into this analysis. In addition, it is not clear to us that the assumed benefits from greater cost reflectivity will materialise given users' inherent commercial interests. It is our view that the likelihood of incremental benefits associated with fundamental change over and above the existing process is questionable. Nevertheless, there may be some potential benefits arising from the qualitative elements of a change in governance including accessibility, effective consultation and transparency, which are in the interests of all relevant stakeholders.

We note that Ofgem proposes that a change to the governance arrangements should be implemented through either Option 2 or Option 3. If one of Ofgem's preferred options is to be progressed we strongly support the need to maintain a high standard in terms of the level of detail that a proposer must provide in order that there is the ability to fully consider any proposal put forward. In particular we feel that a change request must make a specific proposal and be supported by evidence demonstrating that it better meets the objectives of the charging methodology. There is some concern

that under option 2, the proposer does not maintain any ownership of the proposal and as a result there is little incentive to limit “trivial and vexatious” proposals.

National Grid agrees with Ofgem’s view that there is merit in prioritising reform of the charging arrangements in gas and electricity transmission as an initial step, given the levels of forecast investment in this area. We believe that this approach could also provide the additional benefit of allowing an assessment of the success of any change in governance to the charging methodology and the possibility of optimisation if beneficial before it is rolled out across gas distribution.

Given the benefits of increased ownership for those submitting modification proposals, independent administration and closer alignment of charging methodology modifications with associated industry code modifications National Grid considers Option 3 to be the most appropriate option for a change in charging governance methodology. The Initial Proposals document outlines the potential for an amount of extra cost and additional complexity in the implementation of this option compared with Option 2. We feel that the increased cost between the two options is justifiable in providing additional industry benefits and that the increased complexity of subsuming the charging methodology into the relevant codes can be mitigated somewhat by incorporating them as ancillary documents.

As highlighted in the quantitative analysis, each of the options will have both implementation and enduring costs for the NWOs. Clearly, each NWO should therefore be appropriately funded for undertaking any additional responsibilities arising out of a change in governance arrangements.

On the mitigation measures proposed it is our opinion that annual/bi-annual windows would be effective for work planning, but not necessarily in restricting the volumes of proposals. Some further information is requested on the concept of a 3 to 4 month window and this is outlined in the attachment to this letter.

Whilst we are comfortable with the principles of the proposals, we recognise that it is the actual licence and code drafting that is important in establishing an effective regime. Should changes be progressed, we would welcome the opportunity to work with Ofgem on development of licence drafting and discussing the route by which the proposals can be incorporated within existing framework documents. In particular we note that under the Option 3 approach the NWO Licence objectives relating to the charging methodology would appear to need to be transferred into appropriate wider obligations applying to the methodology.

In summary, National Grid does not consider that fundamental change is required, but recognises Ofgem’s view that change could be beneficial as outlined within the Initial Proposals document and feels that of the two options, Option 3 best meets the objectives of the review. More detailed responses to the questions raised within the consultation are appended to this letter.

If you wish to discuss this further, or have any queries regarding this response, please contact me, Ivo Spreeuwenberg on 01926 655897 (ivo.spreeuwenberg@uk.ngrid.com) or Richard Court on 01926 656146 (richard.court@uk.ngrid.com).

Yours sincerely

[By e-mail]

Paul Whittaker
UK Director of Regulation

Appendix: Responses to Ofgem consultation questions

Chapter 3: Initial qualitative and quantitative analysis of impacts

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

The cost benefit analysis undertaken compares the quantifiable costs of implementation, assessment and appeal arrangements to the quantifiable benefits of users internalising, more accurately, the impact that the location of their project has on the network. The costs utilised within this analysis were numbers provided by industry, whereas the benefits were more assumption driven. A minimum benefit required to justify costs approach was therefore taken. The resulting range of required absolute capex savings of between £0.71m and £10.01m for options 2 and 4 and between £0.91m and £10.21m for option 3 appear modest when compared to the cost of network reinforcement.

We note that in opening up arrangements to allow non-NWO parties to propose modifications there is scope for innovative proposals to be brought forward that better facilitate the achievement of the charging methodology objectives. However, given the competitive pressures that users face it is not clear to us that they will in fact bring forward such proposals; it being more likely that users will make proposals that better serve their own interests.

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

Although difficult to quantify, we feel that the impact of possible reduced predictability for those making investment decisions and the potential negative impact on the intra-year cash flows of NWOs should be taken account of in the overall qualitative analysis of options.

In addition, the cost of implementing a new governance methodology and the cost implications for the Authority do not appear to have been factored into the analysis undertaken to date.

Chapter 4: Further Proposals

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

As stated in our response letter, National Grid remains of the view that the current charging methodology governance process can be formalised in a way that meets all the relevant objectives. Nevertheless, of the options proposed by Ofgem, our preference is for Option 3. We have evaluated the characteristics of the two options favoured by those respondents who indicated a desire for change:

	Option 2	Option 3
Implementation	<ul style="list-style-type: none">• Implemented through the relevant licences• The most straight forward and cheapest of the two options considered to implement	<ul style="list-style-type: none">• Converting methodology into an ancillary document to the code is preferable to codifying methodology due to ease of implementation• Code governance will need to be changed to include the charging methodology
Ongoing Governance	<ul style="list-style-type: none">• Governance remains the responsibility of the NWO• More resources required by NWO to consider user proposals and administration• Potential for lack of ownership of proposals once submitted by users, leading to large volumes of changes that may not be beneficial.	<ul style="list-style-type: none">• Governance becomes the responsibility of the industry panel/code administrator• Less additional resources required by NWO than option 2• More resource requirements for code administrator/industry code panel• Industry code panel decides on code changes with an Authority veto that can be appealed to the competition

		commission <ul style="list-style-type: none"> Allows code and methodology changes to be considered in parallel
Timing of methodology changes	<ul style="list-style-type: none"> Change windows may not be helpful as they have the potential to squeeze the same number of changes into a shorter timeframe Implementation windows, in line with the current process, should be maintained 	
	<ul style="list-style-type: none"> Existing arrangements for review by the Authority maintained 	<ul style="list-style-type: none"> Timescales for review by authority move in line with those for code changes
Resulting methodology and charges	<ul style="list-style-type: none"> Cost benefit analysis indicates potential benefits if stakeholders bring forward innovative change proposals that better meet the relevant objectives could outweigh costs Potential for greater volatility in charge structures than the status quo Potential for greater risk of revenue certainty for NWOs within year 	
	<ul style="list-style-type: none"> NWO retains ownership of administrative functions 	<ul style="list-style-type: none"> Industry code panel/administrator takes ownership of administrative functions

The majority of users who preferred change indicated a preference for Option 3. National Grid agrees with this preference and believes that the following benefits outweigh any additional costs and complexities that may arise:

- discouraging proposals that are trivial or do not better meet the objectives through increased ownership for those submitting change proposals;
- increased transparency through transferring ownership of the methodology to an independent industry panel; and
- the ability to assess change proposals for charging methodologies and relevant code change in parallel

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?

Electricity and gas transmission are best placed to take advantage of the benefits outlined in the quantitative analysis in the short term. National Grid believes that there may be benefits in assessing the success of any change to the governance process in transmission before rolling changes out across gas distribution. If beneficial, this could allow for further optimisation of the methodology.

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?

National Grid agrees that the introduction of an annual/biannual change and implementation window would go some way towards aiding effective work planning and allowing for the potential to rationalise multiple modifications where possible. However, we do not think that these windows will mitigate the potential for large volumes of proposals.

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.

The initial proposals put forward 3 to 4 month change windows as being able to provide sufficient time for modifications to be raised. We would like further detail on the nature of the 3 to 4 month window. In particular, we would like confirmation on whether it refers to the time to consider and raise proposals to the Authority or also includes implementation times? The later would not facilitate sufficient time to undertake the entire process.

Given our preference for Option 3, we believe that aligning the timing of windows with those of the panel proceedings outlined in the associated code document would be the ideal timing.

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

We agree with the approach of defining ‘affected parties’ who would be entitled to raise modification proposals within the licence drafting for Option 2 and that Ofgem be able to designate these ‘affected parties’. In addition, we agree that under Option 3, ‘affected parties’ are those who can raise modification proposals as provided for in the relevant code.

It is not clear why, under option 3, there is a need to specifically define ‘affected parties’ within the licence drafting. For the CUSC, paragraph 6(a) of licence condition C10 and for the UNC paragraph 10(a) of Standard Special Condition A11 already define parties that can make a modification proposal.