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9th October 2009

Code Governance Review: Governance of charging methodologies: Initial proposals

Dear Jenny,

Thank you for the opportunity to respond to the above consultation, we do so on behalf of the following RWE companies; RWE npower plc, RWE Supply and Trading GmbH and RWE Innogy.

We are disappointed that Ofgem has dismissed the option of utilising best practice across the various licensees which in our opinion would have secured the benefits of change without the consequent risks and costs.

In our previous response in January of this year we set out how the various charging arrangements work in practice, we do so again as we strongly believe that there is a solution here that works best for industry and the consumer.

There is a standard model that applies to the governance arrangements for modifying charges. The licensee is obliged to keep the relevant charging methodology under review so as to ensure that it meets the “relevant objectives” and to make the necessary modifications to the methodology, if it falls short of those objectives.

There are differences in the applications of the model, in that;

For electricity transmission charges and gas transportation charges, before making any such modifications, the relevant licensee is required to consult those who will be subject to the relevant charges. It is required to submit a report to Ofgem which details;

- The terms of the original modification
- Details of any third party responses to the proposal
- Any changes made to the proposal in light of those responses
- An explanation of how the final proposal furthers the relevant objectives, and
- The proposed timetable for its implementation.

Ofgem then has 28 days from receipt of the report to veto the modification, or 3 months if it wishes to carry out an impact assessment. In the case of electricity distribution charging methodologies, there is no requirement to consult customers or to make available the modification proposal; otherwise the process is the same.

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It seems to us that there are similarities in the existing process to that that exists within the industry code modification process, particularly in the case of electricity transmission and gas transportation.

There are a number of reasons why it may not be in the best interests of customers to initiate major change to the existing arrangements;

- Where the charging methodology no longer fulfils its “relevant objectives”, the licensee has a licence obligation to bring forward a proposal to address that shortcoming. This is not an insignificant incentive as not to do so would be a breach of its licence, which could lead Ofgem to make use of its licence enforcement powers. Ofgem also has powers under the Enterprise Act 2002 to make references to the Competition Commission. These could be regarded as fairly heavy handed but they do provide the right incentives.
- Changes to charging methodologies could affect not only the level of transmission revenues but also the risk profile associated with them. There are of course mechanisms to deal with this but these could add complexity and new regulatory risks.
- Ofgem already has strong powers to influence charging proposals. It has the final say on any proposals, where a charging methodology no longer fulfils its “relevant objectives” the licensee has an obligation to bring forward changes, if this is not done then Ofgem can use its licence enforcement powers.
- Such a change could have a significant impact on the level of work required to administer the process, as empowering customers could greatly increase the numbers of proposals brought forward.

It would seem sensible to adopt the same model across electricity transmission, electricity distribution and gas transportation charging and to make electricity distribution subject to the same arrangements in that modification proposals should be made available and customers consulted.

We also note that that electricity transmission and gas transportation hold forum’s to discuss charging issues – this would seem to be good industry practice that should be extended to electricity distribution.

In conclusion we believe that any of the options other than the status quo option would be disproportionate to the benefits gained. We do however note that there are some best practice gains that would enhance the present system.

We have some comments on the questions raised within the consultation.

Chapter 4 Further Proposals

Question 1

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

As you seem determined to change the process we believe that it should be brought into line with the existing modification processes and therefore option 3 would be the most appropriate.

Question 2

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

Whilst we do not believe that the case has been made for the level of reform suggested, if change is to be made then we believe that gas distribution changing methodologies should progress in the same timescales as that of reform of transmission arrangements.

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?

We agree that these mitigation measures are necessary and appropriate.

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 do not have strong views on whether the window should be 3 or 4 months.

Question 5

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

Of the proposed proposals we believe that option 3 should be adopted, therefore “affected parties” should be those provided for in the relevant code.

Chapter 3 – Initial qualitative and quantitative analysis of impacts

We have no comment on this section – the cost benefit analysis is simplistic.

Should you have any comments or questions on our response, please get in touch.

Yours sincerely

Alan McAdam
Economic Regulation Manager