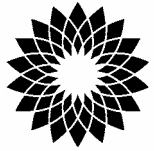




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18 July 2003

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Dear Bryony,

**Gas Retail Governance - Further Consultation - June 2003**

Thank you for the opportunity to respond to this further consultation on gas retail governance arrangements. BP's letter is not confidential and may be placed in Ofgem's library and published on your website.

BP is aware of a separate Gas Forum response to Ofgem's consultation. Please note that BP is not in full agreement with the content of that letter as it differs in a number of respects from BP's own response. Where there is a difference of opinion, BP's view as expressed in this letter takes precedence.

BP has responded specifically to the questions set out in the document but would also like to make a number of general observations.

BP operates as a Producer, Shipper, Supplier and Trader in the UK Gas market and has participated in the development of industry arrangements from the introduction of competition. As an active participant in the development of the Review of Gas Metering Arrangements (RGMA) BP has continued to lobby for the development of greater competition in the provision of non-core services. In particular, we continue to advocate the sale of metering assets by the dominant market participant as we believe their position distorts the market, acts as a barrier to entry for new participants and will as a consequence prejudice Industrial & Commercial (I&C) suppliers where the economics and site conditions mitigate against meter exchange. The developing market structure disadvantages new market entrants and may hinder the operation and limit any benefits arising out of the Supply Point Administration Agreement (SPAA).

BP attends the Gas Industry Governance Group (GIGG) meetings to monitor the development of arrangements since Ashridge. However, BP has become increasingly concerned with the development and scope creep of the SPAA particularly the focus of the development group on mirroring arrangements in the electricity market.

We believe there has been a mindset developing that a SPAA must exist and be mandatory as it believes no governance exists in the retail gas market. However, this view is incorrect as it fails to recognise the reality of the gas market and the role and purpose of the shipper

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entity. Whilst BP recognises that electricity companies have no concept of shippers in their market we would point out that this consultation specifically sets out arrangements to support the gas market.

The gas market has recognised that RGMA needs a home as it cannot be owned by a group but must vest with an entity, and that in so doing a suitable change control structure needs to be facilitated. BP believes the RGMA baseline to be fundamentally stable and that it will not be subject to fundamental change and we believe this has been proven by the volume and type of changes put before the current Change Control Board (CCB). BP is concerned that whilst an entity is required to manage the baseline it should not seek to profit from its stewardship of the baseline for which it has not necessarily contributed in terms of its development.

Membership of SPAA provides little value to I&C suppliers in terms of influencing the development of the baseline. The issues of interoperability can be managed by retaining the principle that the RGMA baseline remains in the public domain and is an open protocol freely available to all.

It is BP's belief that I&C gas suppliers should not be compelled by a Licence condition to be subject to SPAA and for this reason we would not support the introduction of a licence condition. It is also our belief that the baseline should be available to non-signatories and be treated as an open protocol perhaps via the Web, as is the case currently with the document being available on the Ofgem website. BP believes that the extension of the existing Codes Of Practice provides the best approach as it provides assurance regarding consistency and avoids any implied risk to other processes.

The I&C CoP is adequately managed under the existing Gas Forum and as such it is subject to only the lightest governance. BP would point out that since its inception there has been no substantive challenge to the robustness of the CoP by any signatory or consumer.

BP would also point out that in requiring compliance through a licence condition suppliers would be required to "back-off" such compliance with their Service Providers. In your consultation you indicate your belief that suppliers should have the ability to "back-off" the obligations imposed via a licence condition to their service providers. As Ofgem are aware, such arrangements are possible with true commercial service providers, but such compliance has not been forthcoming from Transco MAM. The operation of SPAA could thus be compromised, as the threat of veto from the suppliers' principal service provider could displace the authority of SPAA.

BP addresses the questions specifically set out in the consultation document in the attached appendix as requested by Ofgem. Due to the complexity and detail of the consultation BP would welcome the opportunity to meet with Ofgem to discuss the content of its response and the high level issues raised in the consultation.

Finally, BP strongly recommends that Ofgem issues a further document outlining its detailed response to the many issues raised by respondents to this consultation, and allows further industry consultation and discussion prior to any section 23 Notice being published.

Should you wish to discuss any detail of this response please do not hesitate to contact me or Steve Mulinganie on 07990 972568 (email on mulis1@bp.com).

Yours sincerely,  
**Beverly Ord**  
**Regulatory Affairs**

**Appendix 1 – BP’s responses to the questions raised in the Gas Retail Governance “Further Consultation” June 2003**

**5. The SPAA – Ofgem’s views. The principles of good governance set out above, and the extent to which the proposed SPAA conforms with them.**

BP believe the criteria set out provide a reasonable set of ambitions for any governance regime and would make the following observations:

**Effectiveness** can only be judged with hindsight and it is therefore difficult to venture an opinion on this principle.

**Efficiency** we believe is a key measure however it is important to reflect on the fact that Network Code (NWC) provides an element of retail governance (with price regulation) and the unbundling of these arrangements under SPAA will impose additional costs on all parties.

BP do not support the reduction in timescales for consultations as we believe a reduction in the review period serves no purpose other than to align arrangements with the electricity market. Since there may also be a requirement to align with a NWC modification we see no value in divergence between NWC and SPAA change control timelines.

**Transparency** is a particular concern to BP with regard to the level of visibility afforded under SPAA. The document lacks clarity on how much detail regarding decisions taken by SPAA Executive Committee (EC) or any sub-committee will be provided. The SPAA EC is afforded considerable power and mandates membership of the sub-committees as well as dictating any terms of reference. BP is also concerned that one holding company could hold a number of positions within SPAA and through such membership could exercise an unreasonable level of control over the operation of SPAA.

**Participation** - unlike the electricity market (which developed from a number of regionally based companies) the gas market continues to be dominated in the domestic market by one large player. Whilst an attempt has been made to cap the influence of the largest player the mechanism for vote allocation cascades voting to other larger participants. This has the potential to allow a small group of large suppliers to exert undue influence over the operation of SPAA.

This could also create a disincentive for small players to actively participate and could lead to an even greater concentration of power in the hands of the larger market participants. This is in itself exacerbated by the proposed approach to those who do not exercise votes.

BP is also concerned over the consequences of voluntary accession to the SPAA and the potential loss of protection against the Competition Act (schedule 3) in respect of mandatory elements of the SPAA.

**Accountabilities** - whilst the document sets out the sanctions available to the SPAA EC there is less clarity as to how the EC and its members are accountable for their actions. In fact the document suggests that members of the EC enjoy complete indemnity from the consequences of their actions. Where a party to an elective schedule is suspected of not fulfilling the obligations of that schedule only a party who is also an elective of that schedule may report these suspicions for investigation. As such this could be viewed as not seeking the widest accountability.

**Consistency** - this must include managing the decision-making process such that consistency can be demonstrated over a number of decisions. It must also manage the risk of conflict between governance regimes since the concept of shippers does not exist in the model used to formulate SPAACo. At a high level the SPAA does not appear to be in conflict with existing gas market governance, however BP would caution that alignment with the NWC will require vigilance on the part of the SPAA and will require SPAA to understand the role and relationship of shippers with suppliers. In addition, where changes create

divergence a full cost benefit analysis should be undertaken before unilaterally introducing such change, e.g. the proposal in the document for a reduced consultation period from 15 to 10 days.

#### **Whether a 10 day consultation period is appropriate**

As stated above, BP can see no value in reducing the period in which the industry has to respond to consultation other than it aligns with the practice in the electricity market, which is no justification in itself. Under such circumstances BP would question the application of the lowest common denominator. It should also be noted that existing gas market participants would almost certainly challenge any change to existing practice under the NWC.

#### **Should criteria be developed for the granting of urgent status to a change proposal?**

Whereas the electricity market is dominated by vertically integrated businesses the gas market has developed in a more devolved manner and the underlying NWC contract has continuously evolved to meet customers' requirements as proven by the number of NWC modifications undertaken. As such the gas market has been able to respond quickly to market developments and this has included the ability to introduce an urgent modification where required.

BP would support the adoption of this approach in the retail framework as the supplier would almost certainly be impacted by a change in the shipper's contractual arrangements and would thus need a similar process to effect urgent changes so as not to move out of step with their contractual arrangements with their shipper.

If the option to develop a similar accelerated consultation process is introduced there must be clearly defined criteria and a report should be produced when a change proposal is suggested for urgent status indicating why, by reference to defined criteria, the change proposal has or has not been granted urgent status. Without this it is difficult to see how the process could meet Ofgem's stated governance principles of transparency and accountability.

#### **The preferred method for the introduction of schedules into SPAA**

BP feel the proposals are acceptable however we would like to see more detail as to how these arrangements would be monitored and how responses and appeals would be managed.

#### **The appropriate degree of consumer representatives' participation in the SPAA**

BP would support the inclusion of energywatch as the consumers' representative as this again is consistent with the approach under NWC and would provide consistency between fora. BP believes it is important that a statutory body be considered but not non-statutory bodies. We believe it may be appropriate to tighten the wording to specifically refer to such a body for the avoidance of doubt.

#### **Whether issues of unfair prejudice should be determined as part of the change decision rather than holding a separate appeals procedure**

BP believes the issues under consideration when reviewing whether a supplier or a category of suppliers has been unfairly prejudiced are substantially different in nature than those normally debated as part of the change proposal process. As such it is reasonable that a separate appeals process exists to address these issues.

There is also an argument to suggest that where the issue is unfair prejudice that the appeal should not be referred to the SPAA Forum but should proceed straight to Ofgem for determination. Parties could have a potential conflict of interest should they be asked to vote to support an appeal that could result in increasing the competitiveness of another supplier, possibly to the detriment of their own market.

**Whether the provisions referred to in Paragraph 5.34 should be afforded 'protected' status**

We would support the concern that areas Ofgem regard as protected should require Ofgem's approval for changes to be effective. BP recognises Ofgem's concerns that otherwise changes may be effected to key areas of the document and Ofgem would not have the right of approval. Therefore we would support the expansion of the scope of areas defined as protected where necessary.

**Whether voting should be by reference to the percentage of votes capable of being cast**

BP is concerned that the extra votes are allocated to suppliers who have cast their votes and as such the value of an abstention, whilst a perfectly acceptable option, becomes proportionally reduced when extra votes are allocated. As such this is likely to increase the likelihood of a proposal, irrespective of its merit, being passed.

**The extent of Ofgem's role, if any, in the granting of derogations**

BP is concerned that there is potential conflict if Ofgem are not included in the granting of derogations. The proposed licence modification will require suppliers to accede to SPAA and to fulfill all the obligations associated with mandatory schedules. BP would question whether the granting of derogation by the SPAA EC would remove a licence obligation of a supplier.

**6. The SPAA licence condition. Whether such a licence condition should be placed upon both domestic and I&C suppliers**

BP believes that enforcement of governance through a licence condition goes against the general principle that for two commercial organisations such arrangements should be governed by contract law.

The difference between this and a commercial organisation contracting with a consumer directly is also recognised through such statutes as "The Unfair Terms in Consumer Contracts Regulations 1999" that provides additional protection for consumers above that afforded to commercial organisations.

It is BP's belief that limiting the licence condition to domestic suppliers fulfils Ofgem's obligation to protect consumers and allows for the I&C market to develop subject to market forces. BP is concerned that clarity be provided regarding the voluntary accession to SPAA and how the SPAA agreement would be viewed under the Competition Act. BP would seek confirmation of our belief that, if exclusion were granted via the requirement for accession being driven by legislation, this protection would not be afforded to anyone who voluntarily acceded to the agreement.

**The proposed drafting of the condition, as outlined in Appendix 1**

BP believes that a significant amount of ambiguity continues to exist regarding the drafting of the condition as the option of "shall/may" remains in brackets. We believe the availability clause to be consistent with the Ofgem objective regarding openness. We would note that there is a divergence of views as to the availability of hard copy versions of documentation (Ofgem envisage both hard copy and electronic versions).

**Whether the SPAA has, or is likely to have, any anti-competitive effects, especially in relation to small suppliers or new entrants**

BP believes that the proposed exemption and exclusion from the provisions of the Competition Act should provide adequate protection from prosecution under the Act. However, should voluntary accession be possible the protection afforded under any licence obligation would not be effective and some form of assurance may be necessary if voluntary

accession is to be promoted.

Clearly the need to ensure against a challenge regarding the introduction of barriers to entry needs to be adequately addressed and we welcome the exclusion of entry-testing as exists in the electricity market.

**7. The Domestic Code of Practice. Whether the inclusion of schedules such as that outlined in this Chapter would entirely replace the existing Domestic Code of Practice. Whether the I&C Code of Practice should be developed as a SPAA schedule**

BP believes the operation of the I&C CoP is adequately managed under the existing Gas Forum and as such it is subject to only the lightest governance. Relocating the document into an SPAA schedule is predicated by mandatory accession to SPAA and as such BP do not see value in its inclusion at this point in SPAA's development.

BP also believes that sufficient analysis of the cost/benefit has not been carried out for moving such CoPs into the SPAA and their inclusion is moving focus from the original purpose of the SPAA. We believe that the desire to move CoPs into SPAA is indicative of a loss of focus in the purpose of the SPAA and of the influence of those accustomed to working under the Master Registration Agreement (MRA) regime.

**8. GT involvement in SPAA Whether GTs should become party to SPAA**

BP is concerned that a number of misconceptions exist in the mindset behind SPAA's development and this is predicated by the failure to understand the contractual relationships in the gas market. As previously stated, the concept of a shipper does not exist in the electricity market and the misconception that governance does not exist fails to recognise the relationship between the Gas Transporter (GT) and the shipper and between the shipper and the supplier.

The process commonly known as Change of Supplier (COS) in the GTs' Network Codes should more accurately be termed Change of Shipper, as the Network Codes are predominantly a contract between shippers and the appropriate GT.

There is an argument for removing from the Network Codes those elements of the processes that truly relate to retail activities, but this could require substantial re-development of the NWCs to produce the necessary levels of separation and clarity. Even this level of involvement carries the potential risk of a governance clash because different parts of an end-to-end business process may be subject to different governance with possibly competing objectives.

Whilst Transco GT have sought to remove themselves from retail activities through changes to the NWC they continue to retain control of the majority of metering assets through Transco plc and this provides Transco MAM with significant control over market development. To this extent BP believes that the development of metering competition could be compromised if Transco plc do not to allow the sale or transfer of in-situ assets as envisaged under RGMA.

**Subject to above, the appropriate timing of GT accession to SPAA**

Whilst BP would support the proactive participation of all gas transporters, we believe it is difficult to envisage GTs acceding to SPAA at its formation. In particular, the participation of Transco GT would require significant work in developing schedules; work that has yet to be started.

**Whether becoming party to and compliance with SPAA should be a condition of the GT licence**

Should the decision be made to require GTs to accede to SPAA, the only way to ensure compliance is through a licence condition. As previously pointed out, the only area of interaction at present is in the provision of assets and as such the desire by GTs to operate

significant portfolios of assets needs to be considered. However, it should be pointed out that such arrangements are subject to contractual arrangements directly between suppliers and the GT.

#### **How the funding of change should be apportioned**

The current levels of price caps under which Transco operate include an element for implementation of system changes. The separation of metering should not affect this. Therefore, until the next price review, there would seem to be no reason to make changes to the existing arrangements.

#### **9. Governance of Metering - whether the transfer of the meter asset between suppliers or their agents should be subject to collective governance under the SPAA**

There is a current licence obligation on suppliers to ensure that the transfer of metering assets is achieved as smoothly as is practicable. In addition BP believe that commercial MAMs are incentivised to facilitate smooth transition of arrangements as problems and delays will affect their relationship with their suppliers.

We also believe that the reciprocal nature of these arrangements, i.e. the semi-permanent nature of physical assets against the transitory nature of supply arrangements, will ensure development of efficient arrangements without the need for a draconian and inflexible governance structure from which the MAMs themselves are excluded. It should be noted that the developing MAM market has recognised the need for co-operation and has developed an industry forum to help develop these arrangements.

#### **Whether SPAA should have any role in or influence over the Transco metering contract, and if so, to what extent**

BP can see no logical reason to place obligations on suppliers' agents through mandatory provisions under SPAA that may create conflict with the contractual terms on offer. As previously noted, the MAMs are excluded from participation under SPAA and as such we are concerned about any ability to impose obligations on non-signatories.

BP believes it is more appropriate to consider whether the continuing Transco position regarding making assets available for sale or transfer is inhibiting the successful development of a competitive metering market. As previously stated, BP is concerned over the ability of Transco MAM to hold a veto under the metering contracts which could challenge the impartial operation of the SPAA.

BP believes that Ofgem's influence in the MCG negotiations needs to be continued to facilitate arrangements that allow successful market operation and do not allow any parties to exercise undue influence.

#### **10. Ofgem would welcome views on the indicative timetable**

Since the IMSIF project plan is currently under revision it would be inappropriate to comment at this stage but once the timetable is agreed we will be happy to discuss with you.