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Dear Bryony

Gas Retail Governance – Further Consultation June 2003

SSE has consistently supported Ofgem's initiative to introduce appropriate governance arrangements for the retail gas market that will support both the new gas metering arrangements and the customer transfer process.

In order to achieve this, we understood that Ofgem supported the development of a Supply Point Administration Agreement (SPAA) for the gas market that would be an agreement equivalent to the electricity Master Registration Agreement. Under this framework, the SPAA would not only satisfy the drivers for change, it would also allow market participants an effective voice regarding changes to processes in the retail gas market. To achieve that objective, it is evident that the SPAA must be an agreement between suppliers and Transco GT (in the first instance) since a) Transco owns and operates the core registration processes and hence any change control mechanism that excludes them is meaningless; and b) Transco's SPA process is an integral part of, and inextricably linked to, the new metering arrangements.

We are therefore extremely concerned that the proposed SPAA does not provide for Transco being a signatory at the outset nor has Ofgem proposed a specific licence condition that would require Transco/GTs to be party to, and comply with, the SPAA. We do however welcome Ofgem's discussion on the inclusion of GTs and how this may be achieved. Similarly, we welcome the discussion on the role of the SPAA in respect of Transco's gas metering contracts.

We have significant concerns in respect of the proposed licence condition. We believe that it places suppliers in an untenable position whereby they are required to come to an

agreement with their competitors. In other words, compliance with the licence condition is not within the licensee's gift. Furthermore, we believe that a relevant objective in respect of "the development, maintenance and operation of an efficient, co-ordinated and economical change of supplier process" significantly extends Ofgem's power of regulation to the detailed design of the transfer process. Indeed, we see no reason why the licence condition to comply with the SPAA could not mirror the analogous condition in electricity (Standard Licence Condition 20).

Therefore, we believe that the present proposals do not meet the original objectives of the SPAA and, in effect, achieve little more than to formalise the existing voluntary arrangements to facilitate supplier-to-supplier co-operation and the adoption of best industry practice. It does not provide effective governance arrangements for the retail gas market in respect of either the change of supply process or the new gas metering arrangements.

Against this background, we believe that it could be premature to request suppliers to sign up to the proposed SPAA. As noted above, we are very supportive of the overall objective of the SPAA and we look forward to participating in the industry workgroups to develop this further. Ideally, we would not accept the proposed licence change until the SPAA has been fully developed to include Transco and the SPA change of supplier processes. However, in the interest of progressing the introduction of RGMA, we do believe that we could consider accepting a SPAA that includes Transco and RGMA in the first instance, with the understanding that the SPA change of supplier processes would be migrated into the SPAA thereafter. However, for the avoidance of doubt, our acceptance of a SPAA licence condition is conditional upon Transco being a party to the SPAA.

In addition to the above over-arching comments, we also have a number of concerns in respect of the more detailed provisions of the draft SPAA e.g. Ofgem's role, the change control process, voting mechanism etc. We have therefore set out our more detailed comments on the major provisions of the proposed SPAA and responded to the specific issues that Ofgem has invited us to comment on in the attached Appendix.

If you would like to discuss any of these comments, please give me a call.

Yours sincerely

Rob McDonald
Group Regulation Manager

Appendix 1

SSE Response to Ofgem's paper "Gas Retail Governance – Further Consultation. June 2003"

Section 1 sets out SSE's views on the major provisions of the proposed SPAA as discussed in Ofgem's consultation document.

Section 2 sets out SSE's response to the specific areas of the SPAA that Ofgem has invited us to comment on.

1. The Supply Point Administration Agreement – The Major Provisions

1.1 SPAA Executive Committee. The proposed makeup of the SPAA EC includes representatives from small and large domestic suppliers and I&C suppliers. We do not support the proposal to sub-divide the domestic supplier constituent into "large" and "small" suppliers. We believe that this proposal is unnecessarily complex especially as suppliers will naturally move between the defined categories. The requirement for this sub-categorisation is not required in respect of the Supply licensing arrangements nor is it provided for in the MRA. We therefore see no justification to include it within the SPAA and we therefore believe it should be removed.

Under the MRA, members of MEC (the equivalent body to the SPAA EC) are obliged to consult with their constituents on an equal basis irrespective of the number of customers they supply. We therefore believe that if similar obligations were placed on the SPAA EC members this would achieve the same level of "comfort" that we believe is being sought by seeking to introduce a domestic supplier sub-category.

Based on the understanding that GTs will become signatories to the SPAA, we believe that it may be appropriate to align the membership of the SPAA EC with that of the MEC in the electricity MRA.

As a drafting point, reference to specific dates within the draft SPAA document (eg 1 November in section 6.3) should be in square brackets or left un-defined at this stage.

1.2 SPAA Forum. It would seem appropriate that membership of the SPAA Forum allows for a representative from each SPAA signatory. However, as we have set out below, we do not support the proposed SPAA Forum voting mechanism.

1.3 Change Control. We have significant concerns in respect of the change control process as set out in Section 9 of the proposed SPAA. In particular, we believe that the proposed electronic voting method is too regimented. It does not allow for comments to be sent and reviewed prior to the voting process, nor does it allow for the development of a change control proposal. We do not believe that this is an efficient way in which to govern the change control process and firmly believe that

the MDB process that is adopted within the MRA would be far more appropriate and effective.

We are also concerned that paragraph 9.6 bestows considerable and inappropriate powers on the Change Control Administrator who would be able to "reject a Change Proposal in its absolute discretion".

1.4 Voting. We do not support the proposed voting thresholds. We believe that the voting requirements of the SPAA should be aligned with those that are being introduced in order to facilitate change to the existing licences, although there may be a need to consider changes to reflect the unique market share of British Gas. Failing that, we believe that the voting arrangements should be aligned with those that exist within the MRA in electricity.

1.5 Appeals. We agree that the SPAA should include appropriate appeal mechanisms. However, in addition to the proposed criteria for making an appeal to Ofgem, we believe that a fifth criterion should be included that allows a party to appeal on the grounds that the costs associated with a change/decision are unjustified. In particular, we believe that there should be grounds for appeal where a sound cost benefit analysis has not been carried out and/or where the results of a cost benefit analysis are, in the appellant's view, insufficiently compelling to justify the change.

Ofgem questions whether an appeals process would be necessary in respect of decisions it makes on areas of the SPAA that are afforded a "protected" status. Ofgem suggests that if it were to consider whether or not a particular change unfairly prejudiced the interests of a Supplier at the time it makes its decision, an appeal mechanism may not be required.

We do not believe that there should be any aspects of change that should be approved/directed by Ofgem and we do not see how this proposal sits with Ofgem's declared aim of withdrawing from regulation of competitive markets. Notwithstanding this, we believe that "carving out" some provisions from an appeals mechanism would be wholly inappropriate.

More substantively however, in addition to the right of appeal to Ofgem that is afforded to a supplier in respect of a SPAA change/decision, it is essential that an appeal mechanism exist for parties to appeal an Ofgem decision. The right of appeal in this respect is currently the subject of a DTI and (separately) a House of Lords consultation. We firmly believe that any third party right of appeal should not only be considered in respect of existing industry codes and agreements, it should be extended to include all future industry agreements and codes and, therefore, the SPAA.

On a drafting point, in paragraph 7.26 reference to "a Supplier" should be changed to read "a Party"

1.6 Compliance. We do not believe that the proposed compliance measure that would "withdraw a party's entitlement to receive the benefits of mandatory schedules ….

and the restriction of that party's ability to exercise voting rights" will be effective, especially if the party in question is disregarding these provisions in the first instance. We therefore believe that a more effective mechanism would be to provide for the SPAA EC to report to Ofgem situations where, for example, a party has consistently/repeatedly and/or materially failed to comply with the mandatory provisions/schedules of the SPAA. Ofgem could then investigate such behaviour and, if appropriate, take actions available to it under the provisions of the licensing regime.

We believe that there is merit in considering the introduction of some form of liquidated damages for key situations. However, we believe that rather than attempting to introduce this into the initial SPAA, it should be considered and introduced (if appropriate) once the SPAA has been established using the SPAA governance process.

1.7 Derogations. We agree that there may be circumstances when parties may wish to seek a derogation in respect of certain provisions of the SPAA and that the responsibility and process for granting them should fall to the SPAA EC as described. We do not believe that Ofgem should have a role in this process.

1.8 Schedules. We firmly believe that the SPAA will only satisfy the objectives that arise out of Ofgem's drivers for change if Transco is a signatory to SPAA at the outset and if the SPAA includes on execution mandatory schedules in respect of both the SPA and RGMA processes. Failure to achieve this would mean that, in our view, the SPAA has only achieved a requirement for Suppliers to comply with arrangements that are currently entirely voluntary and ancillary to the core transfer process. Without Transco, the SPAA will not provide effective governance arrangements for either the new RGMA or the change of supply process.

1.9 Others.

- **Objects**. We believe that three additional sub-clauses should be inserted into section 6.2 so that the SPAA EC should also have powers to:

  "Consider and approve and co-ordinate the implementation of any proposals to change any of the data flows referenced in the SPAA schedules";

  "Consider and approve the termination, substitution, replacement or modification of any, or any Variation to, a Services Agreement"; and

  "Monitor and manage the performance and day to day operation of any Services Agreement and to perform the functions, exercise any discretion or make any decisions attributed to it in a Services Agreement".

- **Arbitration**. We believe that paragraph 13.3 is too prescriptive and should be amended to include an intermediate step in the arbitration process that would allow Disputes to be referred to a Dispute Committee as per the MRA.

- **Events of Default Consequences of Default and Limitation of Liability**. We believe that this section, section 10, should refer back to Conditions Precedent. This would be consistent with the MRA.

2. Response to Ofgem's Specific Questions

2.1 The SPAA – Ofgem's Views

a) The principles of good governance set out by Ofgem, and the extent to which the proposed SPAA conforms with them.

We agree with Ofgem's view that good governance should adhere to the principles of effectiveness, efficiency, transparency, participation, accountability and consistency. However, as we have explained below, we are concerned that the proposed SPAA does not conform to at least three of these principles.

Effectiveness: Ofgem's drivers for change and the associated objective of introducing governance arrangements for the retail gas industry mean that the SPAA should provide effective governance arrangements for both the customer change of supply process(es) and RGMA provisions. Transco plays a pivotal role in both of these areas since it is inextricably linked to the systems and processes that facilitate gas retail competition. Therefore, if the proposed governance arrangements of these elements of the gas retail industry are to be effective, Transco must be party to them. However, it is evident that the draft SPAA does NOT include Transco and we therefore do not believe that, if introduced in its current form, the SPAA will be effective. In short, we do not believe that the SPAA as presently drafted could credibly be considered as a framework for retail governance when in excludes the bulk of the processes and single most important party responsible for the existing change of supply processes.

Efficient: Given the above, we do not believe that the proposed SPAA will be efficient. Transco's absence from these governance arrangements will mean that alternative "work around" arrangements will need to be put in place if suppliers are to be given an effective voice in the governance of arrangements that directly involve them and Transco. This will not be efficient. Furthermore, we note Ofgem's view that "the burden the provisions [of SPAA] place upon signatories must be proportional to the benefits they deliver". We believe that in the absence of Transco, the SPAA will not provide any added benefit to the existing voluntary arrangements. Instead, the proposed SPAA will purely add an additional and unnecessary regulatory burden on suppliers that would also be inconsistent with the principle of moving towards a *lighter touch* regulation and Ofgem's intention to withdraw from supply regulation wherever possible.

Participation: We have already explained that, in our view, Transco's participation in SPAA from the outset is of primary importance. Failure in this respect will mean that appropriate governance arrangements will not be achieved.

Turning now to Ofgem's participation in the SPAA. We do not believe that Ofgem

should have a role in approving/directing the implementation of changes to the SPAA. Ofgem's role should be confined purely to the appeals process and, where applicable, compliance in the event that a party to the SPAA has consistently/repeatedly and/or materially failed to comply with the provisions of the SPAA. Any extension to this scope would, we believe, be an unnecessary extension of regulation.

Therefore, in our view, Ofgem's proposed role fails to meet the participation, transparency and accountability "tests" required for good governance arrangements.

b) Whether a 10 day consultation period is appropriate.

Notwithstanding our more detailed comments on the proposed change control process, we have no objection to a 10 day consultation period.

c) Should criteria be developed for granting of urgent status to a change proposal.

We believe that criteria should be developed that would be used to decide whether or not a change proposal should be granted urgent status. At the very least these criteria would be required in order to ensure transparency in the decision making process. We would however expect urgent changes to be very rare and limited to those strictly necessary for security of supply.

d) The preferred method for the introduction of schedules to the SPAA.

We do not think it would be efficient to introduce all new schedules to the SPAA on a voluntary basis and then, subsequently amend the status to either elective or mandatory via the change control process. This seems unnecessarily cumbersome and inefficient. Rather, we believe that a change proposal for the entry of new schedules should also include the intended status at which the schedule would enter. In our view, this approach would ensure the process is both transparent and efficient.

e) The appropriate degree of consumer representatives' participation in the SPAA.

As a point of principle, we do not believe that it is appropriate for third parties to be afforded powers of influence over an agreement to which they are not signatories. Therefore, we do not believe that consumers or consumer representatives should be afforded any powers of participation in the SPAA and their involvement should be no more than having access to relevant documentation, including modification proposals and minutes of meetings. We certainly do not agree that consumer representatives should be able to propose a change to any of the schedules nor do we believe that their views should be given equal consideration to those of the SPAA parties. Moreover, Ofgem have adequate powers under the Competition Act to deal with any suggested "collusion" or anti-competitive practices.

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

Please see our comments under paragraph 1.5 above.

g) Whether the provisions referred to in Paragraph 5.34 should be afforded "protected" status.

We do not believe that any sections of the proposed SPAA should be afforded "protected" status. As we have already stated above, we believe that Ofgem's role within the SPAA should be solely confined to that of an appeals process. In our view, Ofgem's involvement in the approval of change proposals raises a number of issues. In particular, we believe that Ofgem's role in this respect is wholly inconsistent with a *lighter touch* approach to regulation.

h) Whether voting should be by reference to the percentage of votes capable of being cast.

Notwithstanding our views on the proposed SPAA voting thresholds set out in paragraph 1.4 above, we do not perceive that there is an issue with the proposal that voting is by reference to the percentage of votes cast rather than the total votes capable of being cast. However, we would not support a voting process that worked on the principle that a participant's abstention is counted as consent.

i) The extent of Ofgem's role, if any, in the granting of derogations.

We do not believe that Ofgem should have any role in the granting of derogations. The only role Ofgem should have in this process is in respect of the appeals process.

2.2 <u>The SPAA Licence Condition</u>

For the SPAA to be effective (ie to meet the good governance criteria) and to meet Ofgem's (and the industry's) aim of introducing gas retail governance arrangements GTs and suppliers should be a signatories to the agreement on execution and the initial SPAA should, govern both the SPA and RGMA processes. However, we recognise that in the interest of introducing RGMA and RGMA governance arrangements, an interim SPAA that includes Transco and RGMA with an assurance that the SPA processes migrate to the SPAA thereafter, may be acceptable. It is, however, clear that both GTs (at least Transco in the first instance) **and** suppliers should be subject to a new licence obligation to comply with SPAA.

Notwithstanding the above, as we have indicated below, the licence condition as currently drafted raises a number of signficant issues.

a) Whether such a licence condition should be placed upon both domestic and I&C suppliers.

In addition to Transco/GTs, we believe that both domestic and I&C suppliers should be required to comply with the SPAA. The determination of a schedule's status and the category of signatory (i.e. domestic and/or I&C suppliers) that it applies to should

be managed within the SPAA itself.

b) The proposed drafting of the condition, as outlined in Appendix 1.

- We firmly believe that a licence condition in respect of compliance with the SPAA should be no more prescriptive than the equivalent MRA condition found within the electricity Supply and Distribution licences. In other words, we do not believe the proposed licence condition should provide for anything more than "The licensee shall become a party to and thereafter comply with the provision of the SPAA".
- We do not believe that it is acceptable for competing suppliers to be collectively obliged by a licence condition to prepare and maintain a SPAA. In the event that one/many Parties do not agree with a proposed SPAA a licensee's compliance with this obligation is not within its own gift.
- It is essential that paragraph 3.(b)(i) (which requires GTs as well as Suppliers to be parties to the agreement) is included in the final version of the proposed licence condition (and therefore, an equivalent licence condition to comply with the SPAA is introduced into the GT licence). It is also essential that the SPA service is migrated from the Network Code to the SPAA. We believe that failure in these respects will mean that suppliers will be unable to comply with paragraph 1.(a) of the proposed licence condition.
- Unless GTs have the same obligation to comply with the SPAA as Suppliers **and** the initial SPAA includes as mandatory schedules the SPA service, the RGMA baseline and the associated Rainbow contract, we do not believe that the SPAA will meet the Relevant Objectives set out in paragraph 5(b).
- Similarly, unless the SPAA includes the SPA processes we do not believe it will fulfil the requirements of paragraph 6.
- We believe that the inclusion of a relevant objective that provides for "development, maintenance and operation of an efficient and …." significantly extends Ofgem's powers of regulation over the competitive supply market. We strongly believe that this relevant condition is unacceptable since it provides Ofgem with an inappropriate level of "control" over the retail processes to the extent that it could instigate and approve far reaching changes.
- For the reasons set out in our paragraph 2.1.e) above, the reference "energywatch/bodies designated by the Authority" in paragraphs 7.a)(ii) and 7.c) of the proposed licence condition should be removed.
- We do not believe that Ofgem should have any role in the approval of modifications to the SPAA. Therefore paragraph 7.b) should be removed.
- We are unsure why licensees have an obligation to provide a copy of the SPAA to any person upon request. We believe that this should be a function of SPAA EC and provided for within the SPAA itself.

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

We believe that, as currently drafted without the inclusion of GTs and in particular Transco, the SPAA is potentially anti-competitive since, in our view, it is unnecessarily

onerous for smaller suppliers, it creates an unacceptable element of regulatory risk and potentially creates a barrier to entry.

Failure to include GTs and the associated SPA processes will mean that, in effect, the SPAA will have done nothing more than formalise certain existing voluntary arrangements that are at present managed by the Gas Form to facilitate supplier-to-supplier co-operation and the adoption of best industry practice. These voluntary arrangements are ancillary to the core customer registration process. Under the current arrangements, suppliers (unlike Transco) have little or no control over changes that are made to the processes and data flows associated with the change of supplier process. Many of these changes have serious cost implications for suppliers. As the proposed SPAA does not include Transco it does nothing to address this issue. In other words, if the proposed SPAA is implemented it its current form it will have achieved nothing of any benefit to the industry or competition. Instead, it will have increased the regulatory burden for all suppliers, thereby disadvantaging particular suppliers and discouraging new suppliers from entering a market that they have no control or influence over the fundamental processes that they are party to.

2.3 The Domestic Code of Practice

On the basis that the existing Domestic Code of Practice is voluntary, ancillary to the main transfer process and that the SPAA should be seeking to introduce effective governance arrangements of the change of supplier process and new gas metering arrangements, we believe its inclusion in the initial SPAA is of secondary importance.

2.4 GT Involvement in SPAA

We welcome Ofgem's discussion on the inclusion of GTs in the SPAA. Similarly, we welcome the work carried out by the SPAA GT Forum and its conclusion that GTs should be included within the SPAA.

a) Whether GTs should become party to SPAA

We have set out in some considerable detail in the above sections of this response why it is essential for GTs to be signatories to the SPAA on execution and ultimately for the SPAA to include the change of supply and RGMA processes, dataflows etc. Failure to achieve this will ensure that there continues to be no effective retail gas governance arrangements.

b) The appropriate timing of GT accession to SPAA

GT and supplier accession to SPAA should be simultaneous. We do not believe that there is any merit in introducing the SPAA as a supplier obligation in the first instance with a view to creating an enabling framework to include GTs at a later date. A SPAA without GTs and the associated change of supply and RGMA processes will not achieve governance of the retail gas market and therefore serves no real purpose.

We note that RGMA is expected to be included as a mandatory initial schedule to the

SPAA. However, given Transco GT's core involvement in RGMA, we see little point in this unless Transco becomes a signatory to the agreement at the same time. At present, we are aware that Ofgem has a number of concerns in respect of the governance of RGMA baseline. We therefore believe that in the interest of introducing RGMA and resolving RGMA governance on a permanent basis, urgent attention should be given to requiring Transco to become a party to SPAA. Once this has been achieved the initial SPAA could be introduced on the basis that it provided for RGMA in the first instance with the SPA processes to follow.

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

Clearly, we believe that becoming a party to and compliance with SPAA should be a condition of the GT licence. In our view, a future licence condition that requires both suppliers and Transco/GT to comply with a SPAA should be no more than the equivalent MRA licence obligation that currently exists in the electricity Supply and Distribution licences.

c) How the funding of change should be apportioned.

We do not believe that the costs associated with including GTs would be significant especially since we understand that the SPAA has been drafted along the lines of the MRA which includes Distributors and should, therefore, be relatively easy and inexpensive to "copy". Indeed, we would expect robust governance arrangements that include GTs to reduce costs overall.

In any event, we believe that the issue of additional cost and complexity of including GTs/Transco has been exaggerated and highlighted as an issue by those parties that do not favour GT inclusion. We can see no rational explanation for a supplier favouring the exclusion of GTs. The only possible motive for a supplier holding this view would be if it believed that it already enjoys a certain degree of control/dominance over the retail gas processes that would be eroded by an MRA-like agreement being implemented.

Once GTs are signatories to the SPAA we believe that a forumla similar to that used to recover costs in respect of the MRA should be implemented where Suppliers pay two thirds and Transporters one third of the costs.

2.5 Governance of Metering

a) Whether the transfer of meter asset between suppliers or their agents should be subject to collective governance under the SPAA.

We have a number of concerns in respect of metering competition being used as a mechanism to tie-in domestic customers and we therefore welcomed Ofgem's recent draft guidelines on the transfer of electricity meter assets between suppliers or their agents. We understand that Ofgem intends to issue similar guidelines in respect of gas meter asset transfer that we look forward to receiving and commenting on it.

However, in recognition that the obligations in respect of the transfer of gas metering assets is somewhat less clear than those found in the electricity licence, we believe that there is merit in seeking to align these conditions. We do not believe that it is appropriate to seek this clarity through the SPAA. We believe the SPAA should be more oriented towards the actual business processes and data flows that are associated with metering competition and the customer transfer process.

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

Ofgem has identified that unless governance of SPAA and the Transco metering contract are interoperable, proposed changes to the RGMA baseline may have to go through one change control procedure and get industry agreement, only to have to go through it again to change a contract that those same parties are signatory to. Clearly, this would be inefficient. We therefore believe that to avoid these inefficiencies and possible divergence of the RGMA arrangements, the elements of the Transco metering contract that mirror the RGMA baseline (i.e the Rainbow MAM Manual) should be governed by the SPAA. We are particularly concerned that the governance arrangements that have been proposed by Transco in respect of the Transco Metering Contract (which includes the Rainbow MAM Manual) enables Transco to veto any change proposal it does not like. We believe that this is unacceptable.

2.5 Further Work

We understand that the proposed timetable has been designed with a November RGMA implementation date in mind. However, we are concerned that the SPAA does not include GTs. As we have indicated, there is no benefit in implementing a SPAA that includes the RGMA baseline document but not GTs given Transco's pivotal role as a GT in the transfer of information following RGMA implementation. Similarly, since the RGMA baseline is inextricably linked to the change of supply process, the SPAA implementation should be concurrent with the migration of the SPA service provisions from Transco's Network Code to the SPAA.

We believe that the SPAA should be capable of being redrafted along the lines we have suggested (including provision for GTs) before the RGMA deadline, and that, given Ofgem's concern in relation to the interim RGMA governance arrangements, this should be progressed as a mater of urgency.