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Dear Bryony

Gas Retail Governance – Further Consultation

I refer to the above consultation document published by Ofgem in June. This document outlines Ofgem's view on the development of the Supply Point Administration Agreement (SPAA) as well as setting out the licence conditions which Ofgem proposed to introduce to mandate agreement to SPAA.

Shell Gas Direct (SGD) is a licensed gas shipper and a supplier to the industrial and commercial (I&C) market. We have a number of comments to make upon Ofgem's document, the SPAA, and the licence conditions themselves. SGD does not consider the SPAA in its present form to provide any benefits to the I&C market nor to those who supply in that market (particularly those without any parallel domestic supply business) and, therefore, do not wish to sign the agreement. It *may* be that developments could lead to SGD reviewing this position. We do not intend to agree to the licence condition proposed by Ofgem and do not consider that Ofgem has provided sufficient, robust arguments to justify its introduction for I&C suppliers.

Domestic and Industrial & Commercial Supply Markets

SGD recently responded to Ofgem's discussion document on customer switching. In our response, we outlined concerns that terms such as "supplier" and "consumer" were being used without sufficient descriptors to make it clear which market, industrial and commercial (I&C) or domestic, was under discussion. Many of these concerns also apply to this document. We note that this document starts with reference to the *retail* market. As 'retail' is normally defined as sale of good individually or in small quantities to consumers¹, perhaps Ofgem should adopt the convention of referring to domestic suppliers as "retailers" to ensure clarity going forward.

The work on SPAA has largely been taken forward by domestic suppliers, particularly through the Suppliers' Section of the Gas Forum. This Gas Forum's involvement does not mean, and should not be read to mean, that all members of the Forum endorse the

¹ Reference Collins Concise Dictionary. We also note that the Energy Retailers Association has been set up to represent suppliers to the domestic market.

approach being proposed. While we recognise that there are specific processes and issues which arise in that market which could require an agreement such as SPAA, we do not consider that sufficient attention has been paid to the quite different requirements of suppliers to the I&C market and how that market and associated ways of working have developed. Certainly, Ofgem's December 2001 document² indicated that there would be a licence condition applied to domestic suppliers (at least in the first instance). We are not sure when it was decided that this approach should be altered but the communication of this decision was poor. There were only 8 responses to that document and without being able to study the responses, it is not clear that these responses included ones from suppliers who only served the I&C market. A majority of respondents in this context can mean only 5 in agreement. We are aware that there were few I&C respondents to the previous, July document and at least one based their support on full cost-benefit analysis being carried out before this was taken forward.

We clearly do not consider that ICOP should be developed as a schedule to SPAA. SGD has raised its concerns verbally with Ofgem, gas industry governance group members and through the Gas Forum executive. It is unfortunate that the work has developed to this point on the assumption that I&Cs would be included at some point absent any clear engagement with this constituency. We believe that Ofgem should have played a greater role in ensuring that this occurred, perhaps by issuing an update document earlier. While the extent of information available through Ofgem's and others' website is welcome, it is not possible nor practicable to expect minutes of meetings to be read for updates particularly when earlier publications had suggested that the work did not directly affect certain businesses.

Issues and rationale

We consider the issue set out in respect of suppliers' control over Network Code (NWC) processes to be specious. We believe that at least 95% of domestic consumers and probably a similarly significantly high number of I&C consumers are covered by suppliers where the shipper is part of the same business. Even in those rare cases that a supplier contracts through a separate shipper, surely the supplier should ensure that their contract does ensure that their shipper will raise modification proposals on their behalf. Given the high percentage of supplier/shippers in the market, it does not appear likely that investment required for the system changes are stifled. Those with a background in electricity, particularly those working on domestic supply issues, appear not to understand the role of shippers in gas although all the major players in the domestic gas market have shipping licences and are active participants in NWC processes.

We are not aware of any instance of a supplier not being able to get a modification raised by their own shipper and this theoretical possibility is certainly not sufficient reason to institute change. Certainly, a number of modification proposals have been raised by domestic supplier/shippers in relation to supply point administration. The failure of some of these to be agreed by Ofgem is not necessarily indicative of a need to change governance. Furthermore, given that NWC modifications may need to be made in parallel to SPAA modifications, suppliers will continue to be reliant on investment by Transco and shippers in systems. Conversely, shippers and in particular I&C suppliers, may find it more likely that they will need to invest in systems with no benefit to their business. We are not clear as to why Ofgem would consider this to be

² This document was actually published in January 2002 which contributes to difficulties in finding it on Ofgem's website.

an efficient result. It appears to us as likely that SPAA will increase costs as decrease them given, amongst other things, the increased complexity that its introduction is likely to generate. SGD considers that the introduction of SPAA should be subject to a regulatory impact assessment by Ofgem.

The NWC was developed as a contract without explicit licence requirements to avoid “double jeopardy” in that a breach could be subject to both regulatory enforcement and actions through the courts. This principle should be retained. The role of Ofgem (or, previously Ofgas) in that contract is unusual but was introduced to allay concerns that Ofgas had resulting from experiences in the electricity market at that time. The NWC and licences were developed to be complementary but now it appears we are following a model where they are, to an extent, substitutes which overlap.

There appears to be an assumption that parts of the NWC dealing with supply point administration could migrate to SPAA. We would welcome much more detail about what exactly in the NWC is being proposed to transfer to SPAA. Transco is obliged under Standard Licence Condition 9 of its GT licence to establish a network code covering transportation arrangements which, amongst other things, secures effective competitive between shippers *and suppliers*. We are particularly concerned about this in respect of Ofgem’s upcoming document on the proposed sell-off of some of Transco’s networks. We are not sure how Ofgem plans to synchronize these workstreams not least in respect of supply transfers and charging and believe that this needs to be considered. We would welcome detail regarding which parts of the NWC could be, or should be, migrated. All or some of sections E, G, Supply point registration, transfers and isolations affect how much we are billed by Transco for transportation as well as imbalance charges. The DM supply point capacity rules and offtake rates are likely to be amended as part of the next step in the process of reform of the interruption regime. We had expected this issue to be discussed as part of Ofgem’s upcoming document on Transco’s sell-off of its networks.

With the introduction of the NWC, there were a significant number of inter-shipper disputes (ISDs). Experience in the I&C gas market following this demonstrates that problems can be resolved without the need for Ofgem to intervene. This problem has largely been resolved, in part through the Industrial & Commercial Code of Practice (ICOP) as well as through normal commercial processes. It is not clear why Ofgem considers that intervention beyond that experienced in other markets is required for I&C gas supply and we would welcome comment on this in relation to that market.

We are not convinced that the supplier hub principle which now exists in electricity should be replicated and assume this was a view largely supported by the domestic market. It may be a way forward although concerns raised recently in relation to problems experienced by consumers in the transfer process appear largely to relate to problems in the electricity market. Any further move to the electricity model must ensure that the pitfalls experienced to date are avoided.

SPAA

SGD provides below a number of comments on the issues raised by Ofgem in its document as well as other specific concerns regarding SPAA. However, these comments should not be read to mean that, even were the concerns addressed, that SGD would necessarily be in a position to sign up to SPAA.

10 day consultation

We would not support a short consultation period like this being introduced in the first instance and recommend that it starts with 15 days as with the NWC. If consistency with the MRA is required, the MRA could be amended.

Consumer representation

We do not agree that consumers should be able to raise modifications to SPAA. We consider that Ofgem introduced this change for the NWC without properly addressing the issues raised by SGD and others in the “consultations” on this change. We do not consider the fact that Ofgem has introduced this for the BSC, CUSC and recently the NWC, provides sufficient argument to introduce it for SPAA. Ofgem has again not addressed the question of in what other markets, particularly wholesale markets (besides those regulated by Ofgem) allow third parties not subject to the contract to propose change, and has instead merely suggested that the concern is unwarranted. On the assumption that the answer to this is ‘none’, then Ofgem needs to address the question of what special features are there in the gas market that makes this necessary.

Consumer protection cannot be a sufficient reason as we are unaware that consumers are generally losing out in the general marketplaces due to the absence of this right. Ofgem needs also to provide some guidance on the criteria it uses when deciding whether competitive market approaches should be followed or otherwise as it is not clear how these decisions are made. In any case, we note that the ability for third parties to raise NWC modifications is restricted to those release of information and we so no reason for the consumers to be able to do more than this in SPAA. Legal advice sought by GIGG after Ofgem announced its approach indicated that consumer representation would not mitigate competition law risks. Finally, Ofgem suggests that it is appropriate for energywatch to have a role under SPAA given its duties under the Utilities Act. We understand energywatch’s duties to relate to publication of certain information and to the investigation of complaints and are not clear how fulfilment of these duties could be furthered by this role on SPAA.

Ofgem’s proposals in this area only increase the perception that SPAA increases regulatory risk and makes it less likely that SGD would want to sign up to SPAA. However, we support consumers having full access to the documentation on SPAA and being able to make representations to consultations. We support energywatch being the principal representative and being able to attend meetings and provide comments as appropriate.

Voting criteria

We are not convinced that percentages in voting should be based on the total number of votes capable of being cast instead of votes actually cast. We are also concerned that Ofgem underestimates the resource requirements of participation beyond attendance at meetings.

We also have concerns about the formulation of the percentages for voting. If I&Cs were to become party to SPAA, there remains the potential for those suppliers who have portfolios in both markets to be able to influence decisions in the I&C section based on the requirements of their own domestic businesses. We are not certain how this can be satisfactorily resolved but it remains a concern.

Governance and funding

At present, we fund the governance of the NWC through our transportation charges. These are limited as Transco is a regulated natural monopoly. While there is some comfort in the fact that other parties to SPAA are unlikely to warrant excessive costs,

we remain concerned that this proposal in effect is creating an unlicensed monopoly provider of services without the protection of the price control. This is a different approach than Ofgem has taken with Elexon which we understand is owned by NGT, and to at least some extent, controlled through NGC's licence.

SPAA Licence Condition

We have noted Ofgem's principles of good governance in relation to SPAA. However, we would also advocate that principles of good regulation³ should be adopted when taking forward proposals such as this. Absent from Ofgem's list are proportionality and targeting. We do not consider that the introduction of a licence condition which imposes obligations to comply with an industry agreement is proportional to the issues raised (notwithstanding separate issues which may arise in the domestic market). We cannot help but see this as a significant *increase* in regulation and do see it as consistent with Ofgem's stated goals to move towards lighter touch regulation. Obligation in the shippers licence in respect of the NWC are not so all encompassing and limited to specific issues. Compliance with the NWC is a commercial issue (with some important exceptions). We would welcome further explanation as to why Ofgem considers that regulatory oversight beyond what is normally expected in commercial markets is required particularly in respect of the I&C market.

As we noted above, as there were only 8 respondents to the December document, and as that document suggested that the licence condition would only affect domestic suppliers, we are surprised that it is being proposed that the licence condition should also apply to I&Cs without full consultation with this market segment. Furthermore, we consider that no assumption should be made that the licence condition will ever apply to the I&C suppliers. To be consistent with Ofgem's stated objective to withdraw from prescriptive regulation, we consider that further consideration must be given to providing an exemption under the Competition Act removing the need for a prescriptive licence condition. Ofgem states that it does not believe that the SPAA will have anti-competitive effects and, of course, parties to such an agreement will need to ensure their on-going compliance with all provisions of the Competition Act.

We recommend that if Ofgem considers that this licence condition is required, that it is introduced in the domestic section only of the suppliers licence. We further advocate the Ofgem gives more consideration to allowing suppliers to sign up to SPAA without requiring parallel agreement to the licence condition.

Gas Transporters

We have already made some comments in respect to the NWC above. We consider that involvement of the GTs would require substantial work to develop the appropriate separation. We consider that consideration must be given to whether this work can be given sufficient focus both by Ofgem and the industry while we are also considering Transco's sell-off of some of its distribution networks which is likely to be a major project absorbing considerable resource.

Governance of Metering

³ See the Principles of Good Regulation adopted by the Regulatory Impact Unit, formerly Better Regulation Task Force.

Metering competition has been developed in such a way that there is now a requirement for a suitable change control structure. The RGMA baseline appears to be stable. There is no reason to assume that it will be subject to fundamental change in the future and we believe that the industry will prefer stability. However, we are not convinced that the SPAA as developed provides the best approach to providing change control and would advocate development that focussed on the requirements of metering instead of the requirements of domestic supply competition as SPAA appears to be.

Further Work

We consider that the timetable proposed by Ofgem is unnecessarily ambitious. The industry has been through other programmes to meet such timescales on other projects. Experience demonstrates that this often creates problems for the future, the costs of which Ofgem may not see but can and do impact negatively on consumers. While we are not involved in the domestic market, we consider that the number and range of queries outstanding should mean that Ofgem takes a pragmatic approach in taking this forward rather than being unduly concerned about meeting timetable targets. We are aware of discussions which could result in “go-live” in metering scheduled for November 2003 being delayed. This opportunity should be taken to reconsider the SPAA timetable. In our view, Ofgem should publish a further document outlining its response to issues raised *before* any Section 23 notice is published.

Way Forward

As outlined above, Shell Gas Direct does not currently consider that there is value in signing the SPAA. We would not agree to a licence condition requiring us to sign up to it being introduced. We would welcome responses from Ofgem to the issues raised by us and others before any proposals to change any licence conditions are taken forward. We highlight the following issues in particular:

- Ofgem has stated that it wants to move towards light touch regulation. We cannot reconcile this position with Ofgem’s intention to introduce a licence condition with increased obligations on suppliers. We would welcome a further exposition beyond the fact that Ofgem approves all modifications to the Network Code and would not for SPAA.
- Ofgem’s consideration of the SPAA itself and relationship to Competition Act, voluntary agreements etc
- Explanation by Ofgem of the criteria it uses for deciding whether gas markets should be treated as any other market or instead where Ofgem interprets its regulatory duties to require arrangements beyond what would normally found. This needs to be addressed specifically in respect to consumers being able to make proposals to change contracts but applies to a number of projects in which Ofgem is involved.
- A regulatory impact assessment on the introduction of SPAA for both the domestic and I&C markets is vital and should be carried out by Ofgem before proposals to modify licences are made.

Shell Gas Direct is a member of the Gas Forum. However this does not mean that SGD supports all initiatives taken forward by workgroups of the Forum, nor that the Forum necessarily represents SGD’s views. We understand that the Forum has submitted its own response to this consultation and while we are supportive of much that it contains, this should not be read to mean that we fully agree with its contents.

If you have any queries regarding the issues SGD has raised in this response, please feel free to contact me on the above telephone number.

Yours sincerely

Tanya Morrison
Regulatory Affairs Manager