

1 Summary

As the foremost provider of governance services within the energy retail sector Gemserv is essentially neutral to the ownership of assets and to the detailed matters of operation within a disaggregated distribution business. However it is vitally interested in the changes the proposed disposal requires to the governance regime and opportunities it may bring to improve on current arrangements. This response therefore concentrates upon the governance aspects of the consultation.

It is Gemserv's firm belief that whatever governance regime is chosen it must represent the best possible fit to the Principles of Governance articulated in Ofgem's earlier consultation document Gas Retail Governance. Equally, the solution must be consistent with light touch regulation and Gemserv would anticipate that, as a minimum test, Ofgem would have no additional involvement in a post-disposal industry compared with today and indeed the objective should be to arrive at a regime where regulatory input is actually diminished over the short/medium term.

A further test of the chosen business structure, licensing and contractual arrangements must be that they have no adverse impact on the operation of the competitive retail market either for existing participants or new entrants. In fact the construction of a revised industry regime presents an ideal opportunity to address some of the competitive difficulties arising from the present proliferation of arrangements and network codes and must be very carefully considered for incorporation.

2 Decision Making Framework

Gemserv will maintain a keen interest as the work progresses and is willing to participate both in constructive dialogue and in whatever other practical ways that it may most effectively contribute. Principles of Governance

In its earlier Consultation Document Ofgem listed six principles or characteristics of good governance that should be adhered to by any "governing body, code or agreement". They are effectiveness, efficiency, transparency, participation, accountability and, consistency. Gemserv has also suggested adding the following general characteristics to the list;

1. Direction – the arrangements should have some overall objectives by which to judge the desirability and priority of change.
2. Impartiality - the agreements and rules for change control should be operated for the benefit of all legitimate constituencies and without undue influence from any one of them.
3. Evolution – built in ability to change the rules governing change and their operation where this can be shown to better conform to the principles.
4. Clarity – the chosen regime should be as simple and uncomplicated as is consistent with the task at hand.

3 NGT's Proposals

Gemserv believes that whatever the substantive contractual arrangements might be in a disaggregated industry the overarching governance regime into which they fit should conform to these principles in as far as it is practical. Should divergence from the principles prove necessary then it should be undertaken as a conscious decision as a last resort and the reasons for deviation should be reviewed/confirmed following a period of operation. Specific Points

3.1 Timescale

The consultation document contains what is described as a "possible timetable" which suggests that the disposal of one or more Distribution Networks (DNs) could take place as early as September 2004 (although it acknowledges slippage "...cannot be ruled out."). It is Gemserv's view that implementing profound change such as that proposed should not be rushed in order to meet what appears to be an essentially arbitrary target date. The timescale should be driven by the application of an open inclusive process of examining the various issues rather than having the process constrained by the timetable.

In particular it might be appropriate to test the process to be used in deriving a timetable against the principles of transparency, participation and accountability as set out by Ofgem.

It would seem appropriate for NGT to engage with and convince the industry of the robust nature of its proposals via constructive debate at the earliest opportunity. Gemserv is willing to participate in such debate in respect of the governance issues.

3.2 Regulatory Architecture

In paragraph 4.59 Ofgem requests views on a number of specific matters, which are grouped together for convenience in this response;

3.2.1 Internal Vs full structural separation

Gemserv understands that Transco now intends to bring about corporate separation of the Distribution Networks and will be interested to see the extent to which it is planned that each of the Retained Distribution Networks (RDNs) will be separated from each other. It is possible that there may be opportunities for the RDNs to act in concert to the detriment of IDNs individually or as a group.

Gemserv would like to see Transco make a recommendation that the industry can assess and comment upon with the principles of efficiency, transparency and accountability being paramount in judging the requirement in this area.

3.2.2 Licencing Arrangements

Ofgem has outlined two possibilities, Option 1 being a separation of transmission and distribution activities and “repackaging” into two licences and Option 2, minimum change. Option 2 has the attraction of relative simplicity and minimal delay whereas Option 1 will be more disruptive to the present arrangements and will require more work to achieve.

Gemserv believes that in reality this question is related to the debate concerning the separation of wholesale Vs retail activities, it is triggered yet relatively unaffected by the ownership of physical assets. Such separation should bring greater clarity to the “ownership” of obligations and incentives via revised regulatory and contractual relationships and needs to be considered across the whole licencing regime. Gemserv believes the opportunity to review the present regime and separate these sets of activities wherever possible should be carefully considered and planned for.

Such a review lends support to Option 1 although there are many practical detailed issues to be resolved. One such is the need to avoid introducing over complex regulation and/or contractual regimes. For example it can be argued that activities within the DNs are likely to be a mix of wholesale and retail in nature as some are conducted in aggregate (e.g. LDZ capacity) undertaken by shippers, whilst others relate to supply points (e.g. change of supplier) and are properly carried on by suppliers via the transporters Supply Point Administration (SPA) service.

In developing the new licencing regime it will be important to ensure that it does not unduly constrain the industry or introduce unnecessary layers of complexity by, for example, requiring shippers to be party to separate network codes and suppliers to separate SPA arrangements within each DN. Gemserv believes that it is desirable review the shipper and supplier licences alongside the separation issue and to make a conscious decision to start with minimum change moving to separate revised licencing over time and at a pace that the industry can plan for and absorb.

3.2.3 Network code arrangements

3.2.3.1 Structure of agreements

In setting out “transportation arrangements” a transporters network code (NC) provides the contractual framework for use of the pipeline system. As such it is predominantly concerned with wholesale activities as conducted between transporters and shippers in which the entire pipeline system is often treated as a single entity and the shipper deals with its requirements in aggregate across its suppliers supply point portfolio. For largely historical reasons NCs have also provided the retail arrangements, collectively termed the SPA, which are in principle transacted at individual supply point level between transporters and suppliers with the shipper simply acting as an information conduit between the two.

With the creation of the Supply Point Administration Agreement (SPAA) to provide supplier inter-operability it is widely anticipated that the retail processes within NCs will migrate to the SPAA and become subject to its governance arrangements. This migration process and the transporters potential role under the SPAA have yet to be

worked out in detail but cannot be ignored in the context of the present consultation and are in any event likely to have been implemented before any separation takes place.

Gemserv believes that the principles of good governance must be used to provide the target framework for any revised NC, modification rule and SPAA arrangements. This translates into having as few separate contractual arrangements as practical, signed between the appropriate sets of licencees, underwritten by appropriate licence obligations and with governance regime(s) which are as seamless, transparent and non-discriminatory as possible.

Translating this high level intent into a structure for codes suggests a need for the following;

- A Transmission Code (TC) covering system wide activity (e.g. energy balancing and settlement) and specific NTS requirements (e.g. entry capacity), between Transco as NTS operator and shippers.
- An Offtake Code (OC) covering the largely operational matters at the transition between the NTS and DN, and (potentially) between the DN and IGT system operator replacing the Network Exit Agreements currently in place. These agreements would be signed between the system operators on both sides of the relevant offtake and would contain information and arrangements specific to the particular offtake in addition to a common set of principles.

A Unified Network Code (UNC) covering wholesale activity on all DNs regardless of asset ownership (i.e. including those operated by Independent Gas Transporters), between the DN operators and shippers. The extent to which activities within DNs are wholesale and therefore shipper oriented as opposed to retail and hence will be migrated to SPAA remains to be seen. In principle however DNs should not have separate NCs if they are needed. It is possible to envisage shipper related DN activity being included within the TC but this may overcomplicate that regime (see below). The SPAA covering retail (i.e. supply point related) activities throughout the system, signed by suppliers and transporters. I can't get these last two paras back into bullet points – help!!

3.2.3.2 Possible modification arrangements

In the structure outlined above there are four logical “constituencies” with a legitimate and direct stake in the modification procedures, some of which may need to further sub-divide for reasons of practicality (e.g. DN operators and IGTs and Domestic and I&C suppliers);

1. NGT as NTS operator,
2. Shippers operating on the NTS and/ or DNs,
3. DN operators (inc NGT and IGTs) and,
4. Suppliers.

Naturally there are others with an interest in the outcome of modifications, such as customer representatives, but arguably they should not be as closely involved in the modification process itself.

It is possible to envisage a governance regime which recognises and accommodates the interests of each constituency with a set of checks and balances to ensure each is fairly treated. There are existing models that could be usefully adapted both in the electricity industry and within the SPAA.

In Gemserv's view it is important to analyse the requirements for a modification framework from first principles and to resist the natural temptation to create a proliferation of different rules governing each commercial agreement unless and until a uniform regime has been shown to be impractical or unworkable. Gemserv therefore recommends that a specialist workgroup be established to recommend the modification set up for the post DN sale gas industry.

In 7.59 Ofgem invites views on several aspects of the SPA arrangements proposed by Transco;

3.2.4 Transco agency

NGT's suggestion is that its central services such as SPA, shipper billing and data management could be put into a separately identified and managed business unit and provide services back to the NTS and to the full range of DNs (potentially including IGTs). This proposal will have attraction for the industry in that it avoids the need to have separate service providers on each DN with the risks that that would bring to efficiency, costs and to the customer transfer process.

In principle Gemserv supports the agency concept as it offers a more practical, manageable and economic solution than a model in which service provision is necessarily fragmented between DNs and in which standards of service could vary to the detriment of customers. Having said this it is important to ensure that the agency is constructed in such a way that encourages the development of competition in the provision of services. This is explored further below.

3.2.5 Funding and ownership

There are several specific issues in this area on which Gemserv is essentially neutral. It would however suggest that these questions be considered in the light of the principles of governance in order to provide an agency, which is most likely to be effective, efficient and transparent in the provision of consistent and non-discriminatory services. This might indicate that the minimal change proposed by NGT would be less likely to deliver an optimised service than a more radical approach.

There may be a workable model in which ownership and funding of the monopoly aspects of the agency (e.g. the supply point database) are retained within the regulated businesses to the benefit of the industry. The provision of services based upon that data could then be open to service providers working in competition with the NGT agency, providing innovative services based around a universal minimum standard. Such an arrangement could work in a similar way to the unbundling of meter reading with suppliers and shippers choosing to switch their service provider if and when it suited their business.

In any model it is important that the funding arrangements do not provide inappropriate incentives on NGT or other service providers to maintain the status quo despite changes having been requested by the industry. Funding for the implementation of changes to the monopoly aspects of the agency would need to be provided in such a way that NGT/DNs are appropriately recompensed, possibly after the change is made, in order to incentivise progress.

3.2.6 Governance of the agency

It is Genserv's view that the governance of the agency cannot be considered separately from the governance of the business processes that it supports. The great majority of data used and services provided by an agency will be supply point specific and hence will be retail in nature. As stated elsewhere it is anticipated that retail activities will fall under the auspices of the SPAA and its schedules, e.g. the Revised Gas Metering Arrangements (RGMA) baseline, hence it is logical to believe that the management and modification of the services provided on behalf of suppliers should equally fall under the SPAA.

This would require revision to the present SPAA drafting to accommodate the agency and transporters in the role of service provider. It may also be necessary to consider shippers if they are to remain as information conduits between the agency and their suppliers. Work is presently ongoing under the auspices of the Gas Forum to define changes required to SPAA/NC governance to facilitate RGMA, and further work is planned at an appropriate time to encompass migration of SPA from NC to SPAA. This could potentially be expanded to consider inclusion of the agency role.