☰Scottish and Southern Energy plc

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Date: 2 April 2004

Dear Nick

Gas Retail Governance – Final Proposals March 2004

Further to Ofgem's previous consultations on the above, we are pleased to respond to Ofgem's final proposals on the future governance arrangements of the gas retail market.

As you are aware, we very much support the development of gas retail governance arrangements through the implementation of a SPAA that governs the customer transfer process and competitive metering arrangements. Given the importance of these processes, we welcome Ofgem's decision that both suppliers and GTs would need to become signatories to SPAA on day one.

Notwithstanding the above, the proposed standard licence conditions and elements of the SPAA itself pose a number of significant issues. We would urge Ofgem to reconsider its position on these issues before bringing forward licence conditions in the form presented in the consultation paper.

In particular, we are concerned that if implemented, the licence conditions would cause a fundamental shift in responsibility for the maintenance and facilitation of competition between suppliers and the associated customer transfer process from GTs to suppliers. We are also extremely concerned that Ofgem does not believe I&C suppliers should be subject to a SPAA licence condition. Furthermore, as drafted, we do not believe that it is within the gift of a supplier to meet the requirements set out in the proposed licence condition.

We are also concerned that the drafting of the SPAA significantly extends the powers of energywatch. That is, by being able to raise modifications to the SPAA and schedules contained within it energywatch would, in effect, have an opportunity to directly control and influence the retail gas arrangements. It would not however have any corresponding

duty to consider the cost of its proposals or to conduct a regulatory impact assessment. This power has not been either envisaged or provided for by legislation and we therefore do not believe that it is appropriate.

We have expanded further on these, and other issues in the attached Appendix 1.

Although we recognise that the immediate driver to implement SPAA is to provide a governance framework for the RGMA baseline in time for go-live in July, we do not believe that it is appropriate that this driver takes precedent over resolving the issues that we have identified. Therefore, in the event that it is not possible to adequately address these issues before RGMA go-live, interim, formal RGMA governance arrangements that would apply for RGMA go-live should be sought (possibly via a new licence condition).

Please give me a call if you would like to discuss any of the points we have raised.

Yours sincerely

Rob McDonald
Director of Regulation

Appendix 1

SSE's Detailed Response to Ofgem's Final Proposals for Gas Retail Governance

SPAA Licence Conditions

The rationale behind the development of the SPAA, in our view, has always been to introduce appropriate governance arrangements for the retail gas market that will support both the new gas metering arrangements (RGMA) and, whether initially or at a later date, the customer transfer process. On this basis, we have supported the principle that both Transco and all suppliers should be required by licence to be a party to, and comply with, the proposed SPAA. In so doing, we believe the above objective would be met and retail competition would be facilitated by the development and maintenance of standard industry processes and interoperable data transaction formats enabling market participants to communicate effectively.

Licensing of Suppliers

Based on the above, we support the principle of introducing a supplier licence condition to comply with SPAA. However, we are concerned that the drafting of the proposed condition raises a number of issues that need to be given careful consideration. We discuss these below.

1. We are concerned that the requirement to develop and maintain a SPAA that meets the relevant objectives set out in the draft licence condition has been placed on suppliers rather than transporters (Transco). We believe that this represents a significant transfer of existing obligations that are currently placed on the monopoly Gas Transporter and:

   a) In effect, duplicates the obligation of securing effective competition between relevant suppliers contained within Standard Condition 9 of the GT licence and Transco's Amended Standard Condition 9.
   b) It places suppliers in a position whereby they cannot achieve the relevant objectives set out in the draft licence condition. This is because the central systems and processes associated with SPA processes are owned and governed by GTs. That is the obligation is divorced from the ownership of systems that carry out the function. Furthermore, suppliers are not signatories to the GT Network Codes that govern these arrangements and, therefore, they would have no power or mechanism to transfer the SPA processes from the relevant Network Codes to the SPAA.

2. The obligation on suppliers to prepare and maintain the SPAA "in conjunction and co-operation" with all other suppliers places suppliers in an untenable position whereby they are required to come to an agreement with their competitors. It is inevitable that considerable tensions will exist between competing suppliers and agreement on key issues is likely to be difficult to resolve and will, in our view, mean that compliance with the licence condition is not within the individual licensee's gift. This concern is not only related to paragraph 1 but also paragraph 6.a) of the

proposed licence condition.

3. Although we understand that it is not intended to do so, we are nevertheless concerned that the proposed licence condition potentially significantly extends Ofgem's powers of regulation to the detailed design of the transfer process. Equally, if not more importantly, the draft SPAA allows for considerable involvement by energywatch including the power to raise a modification to the SPAA and schedules contained within it. This is unacceptable and provides energywatch with significant and greatly extended powers to "direct" the development and operation of the gas retail arrangements. As noted earlier, this new power would not be balanced by a corresponding duty to consider the costs of its actions.

4. In the event that a licence condition is to be introduced, we are most concerned that Ofgem does not believe that it should apply to I&C suppliers. As we have set out above, and which has been reiterated by Ofgem in paragraph 3.1 of the consultation document, SPAA was developed on the grounds that suppliers considered it was necessary that all suppliers would be bound by the requirements of the SPAA, which in turn would enable the effective operation of the gas supply market. If one category of supplier is not required to comply with these arrangements the SPAA has, in our view, failed to achieve this key objective. It also makes it impossible for suppliers bound by the licence condition to comply with it since, by definition, if one category of supplier is not required to comply the licensee can not develop a SPAA in conjunction with all suppliers. Therefore, unless all suppliers are bound by the same licence condition the effectiveness of the SPAA will be seriously damaged.

   Furthermore, it is apparent that competitive retail arrangements (including metering arrangements) do not distinguish between domestic and I&C customers. Rather, a distinction is made upon whether a site's Annual Quantity (AQ) is greater than or less than 73,200kWh (Large Supply Points and Small Supply Points respectively). Although the majority of Small Supply Points are "domestic" customers it is clearly evident that many are also I&C customers. Therefore, where a change is made to systems and processes associated with Small Supply Points it will inevitably have an impact on I&C suppliers meaning that, if they do not comply, they, and importantly their customers, are likely to be adversely affected.

   There are two possible options to avoid this situation arising. The first would be to require Transco/Suppliers to identify Small Supply Point I&C customers within their systems/processes so that changes would not apply to them. In our view, this would be a significant change that would have a significant cost associated with it (and it is not clear who would meet that cost). Alternatively, I&C suppliers could be required to comply with these changes. In our view, the latter option is clearly preferable. Therefore, in order to protect the integrity of the processes contained within SPAA and in the interest of retail supply arrangements, we firmly believe that I&C suppliers should be required to become a signatory to SPAA and if necessary, mechanisms within SPAA should govern whether or not they are obliged to comply with the various provisions. If this is not achieved, we question whether I&C suppliers should be given voting rights within the SPAA.

In order to address the above issues, we propose that, ideally, the SPAA licence conditions should be reconsidered placing the obligation to develop and maintain a SPAA upon Transco in the first instance, and other GTs as and when required (determined by say, the number of customers connected to their systems). In addition, ALL suppliers, that is domestic and I&C suppliers, would have a simple, "must comply with" obligation (as currently proposed for GTs). This would better facilitate the transfer of all retail supply governance arrangements (including SPA and RGMA processes at the very least) into the proposed SPAA and to that end, is more likely to achieve the original intent of the SPAA.

Nevertheless, we do recognise that the immediate driver for the proposed SPAA is to provide formal governance arrangements for the RGMA baseline and it may not be possible to achieve the transfer of obligations from supplier to GT as we have suggested before RGMA go-live in July. Therefore, interim, binding RGMA governance arrangements would need to be agreed. To date, the RGMA baseline has been managed by the Change Control Board and IMSIF with Ofgem facilitating the administration of these arrangements. We therefore believe that it would be possible to for these arrangements to be extended post RGMA go-live and until an appropriate SPAA framework has been implemented. It may also be necessary to formalise this in a new and simple licence condition requiring suppliers and Transco to comply with the CCB/IMSIF change control process in respect of RGMA.

If this approach is not adopted, we believe that careful consideration must be given to each of the concerns that we have outlined above. However, it may be possible for Ofgem to provide us with some sort of comfort that the proposed SPAA licence obligation would not be used by Ofgem to increase its direct control of the gas retail arrangements. Similarly, we would need comfort that Ofgem would not use compliance with the licence to "force" a supplier to consent to the implementation of a modification proposed by a direct competitor due to a fundamental conflict of interest and the impact it would have on our supply business. We would also need assurance from Ofgem that all suppliers have equivalent conditions applied to them. Finally, and most importantly, the role of energywatch as provided for within the draft SPAA should be significantly curbed to the extent that, as a minimum, energywatch could not raise modification proposals.

Licensing of GTs

We welcome Ofgem's recognition that GTs should be required to be a signatory to and comply with SPAA from day one.

However, as we have already identified above, we believe that the obligation to develop, maintain etc the SPAA should lie with GTs (Transco in the first instance) and not suppliers on the grounds that GTs currently have the obligation to secure effective competition between relevant shippers and between relevant suppliers. This would focus that obligation on the parties that own and operate the processes and systems associated with the change of supply process. In other words, we believe that a licence obligation similar to that contained within the electricity distribution licence in respect of developing, maintaining etc the MRA would be more appropriate. This would also

ensure that SPA processes are transferred from the Network Code to the SPAA as per the original intention.

Furthermore, we have some concern that placing the requirement on all GTs in the first instance may, place unnecessarily onerous obligations on iGTs that had not been envisaged. For example, the Gas Forum GT working group has already identified that iGTs would not be able to comply with the RGMA baseline at this stage. Therefore, there should be sufficient flexibility provided within the SPAA to enable a iGT's compliance with certain provisions to be voluntary, rather than mandatory at least for an interim period.

Other Issues/SPAA Drafting Issues

1. **Consumer representation**. As we have already mentioned, we firmly oppose Ofgem's decision that energywatch should be able to raise modifications to the SPAA and its content. We believe that this provides energywatch with considerable power to direct the way in which the competitive gas retail arrangements operate without any corresponding duty to conduct regulatory impact assessments or even to consider the costs of their proposals. Furthermore, although energywatch would not be a signatory to the SPAA, given its proposed role we believe that energywatch should be bound by the confidentiality clause contained within the SPAA.

2. **Ofgem's Role/Appeals**. We are very concerned that, as proposed, Ofgem will determine whether or not a modification to a mandatory schedule or "protected" element of the SPAA would be implemented - when it too is the ultimate decision maker in respect of an appeal on these same decisions. Ofgem has stated that it will set out procedures to follow should an appeal be raised against a modification that has been directed for implementation by Ofgem. Nevertheless, we believe that it is inappropriate for Ofgem to have these concurrent responsibilities. As a minimum, therefore, it is essential that a third party right of appeal mechanism exists for parties to appeal to an independent body Ofgem decisions. Failing that, Ofgem should not have any role in the approval of modifications to the SPAA. We are aware that this issue of third party appeals is being considered as part of the Energy Bill. However, at this stage it is not clear that the proposed right of appeal will cover decisions associated with the SPAA.

3. **Change Control.** We continue to oppose the electronic voting mechanism that is contained within the SPAA on the grounds that it is too regimented. We also believe that there are considerable cost implications associated with developing an internet-based electronic voting system. In any event, it is unlikely that an electronic voting mechanism will be operational on day one of SPAA and, therefore, interim or "standby" voting mechanisms must be considered. Indeed, the development of an alternative mechanism will be particularly important in the event that, for some reason, a signatory to the SPAA is unable to vote electronically at any particular time for technical or other reasons.

   We are disappointed that our previous comment that no specific provision would be made for the development and consideration of change proposals prior to voting has

not been addressed. That is, we believe that rather that relying solely on the electronic voting mechanism, it would be more efficient for an arrangement equivalent to the MDB process within the MRA to exist whereby a forum is established for modifications to be discussed and developed by the industry (as appropriate) to facilitate the optimum solution.

We are also concerned that paragraph 9.6 of the draft SPAA bestows considerable powers on the Change Control Administrator who would be able to reject a change proposal in its absolute discretion. We believe that this is not appropriate and could potentially result in alternative modifications that have subtle differences being rejected. Instead, we suggest that the SPAA EC should agree and issue appropriate procedures in this respect.

4. **Funding.** We believe that it would be appropriate for all parties that are signatories to the SPAA to contribute to its operation (i.e. secretariat costs).

SSE
2 April 2004