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Dear Sonia,

National Grid Transco – Potential sale of network distribution businesses
Agency and governance arrangements – RIA

Thank you for the opportunity to respond to this Regulatory Impact Assessment. BP's response is not confidential and may be placed in Ofgem's library and on its website.

BP has followed the DN Sales debate through active participation in the Agency workgroup and the Gas Forum NGT DN Sales workgroup. Given the ongoing activities involved with major projects such as RGMA (due for implementation on 12 July 2004), many industry participants have had limited resources to attend all the DN Sales workgroups and to thoroughly review all the documentation produced. It would be very helpful if Ofgem could organise an open seminar to explain the decisions it is expected to take at the end of May with regard to the operational, commercial and regulatory framework that is to be developed to support a divested industry structure. BP hopes to be able to participate in the development of this framework.

Before commenting specifically on the range of options under consideration for the agency and governance arrangements. We would first like to make some general observations on what we see as key principles;

- Customers must not be adversely impacted
- Agreement to a Uniform Network Code – there should not be any short form network codes as this would lead to industry fragmentation, increasing administration costs for shippers in maintaining and operating multiple codes. If, for geographical reasons, a DN needed to operate in a different manner than the Network Code stipulated, a reference to geographical differences could be inserted into the Uniform Network Code.
- There should be Common Pricing methodologies across all DNs – this could in time lead to a complex pricing structure that shippers would need to maintain.

BP highlights the following observations from the document:

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- The agency would be a central service provider that could discharge many of the functions and services that are currently provided by Transco following a potential sale of DNs. The purpose of this would be to minimise and mitigate the costs associated with moving to a more fragmented industry structure.
- Although there are some figures provided within the RIA, the use of ticks and crosses has limited meaning in terms of the interpretation of their values,
- Total agency costs that could be occurred are not specified anywhere in this RIA,
- There is no option representing "no change". Ofgem is not considering a "No Agent" option.
- We are pleased that Ofgem has recognised that there are important differences between the gas and electricity sectors, and that the ELEXON model may not be appropriate for the gas market.

Impacts of a potential DN sale

Ofgem recognises that the potential sale of one or more gas distribution networks has significant implications for the systems and process interfaces that presently exist between shippers, suppliers and Transco. In this respect, the sale of DNs could require changes to data management, supply point administration (SPA) and system operation information interfaces as shippers and suppliers may need to develop different processes and systems to deal with different DNs. The creation of fragmented processes and systems has the potential to impose significant costs on shippers and suppliers, and may also create barriers to entry to wholesale and retail markets. Ofgem also recognises that these costs would ultimately flow through to customers. Independent research carried out by Oxera on behalf of the Gas Forum, to which BP has contributed, highlights there is a significant cost to shippers (see later section).

Ofgem further recognises that Transco's proposals to retain ownership of one or more DNs following a potential sale will also create the potential for it to discriminate in favour of those DNs that it continues to own, over those that it has sold. This has potential to distort wholesale and retail markets and increase operational costs for DNs and may, ultimately, impose costs on customers.

Ofgem recognises that the DN sales process presents some risk to retail competition. For example, if DNs were to be responsible for the change of supplier process, there is a risk that the process for customer switching could become non-uniform over time. Fragmented switching arrangements might increase the change of supplier failure rate, attracting bad publicity that might impact adversely on customer switching rates. It would also increase costs to suppliers. Greater fragmentation could also be expected to increase the level of customer complaints. We must ensure that customers are not adversely impacted.

The agency proposals seek to prevent any negative impact on competition by preserving a single uniform interface between network operators and shippers, however, the agency could potentially weaken competition in metering and connections if it takes on functions that encourage shippers and suppliers to continue to use the incumbent service provider rather than considering alternative service providers.

Accountability

It is essential that functions are allocated between the NTS, DNs and the agency in a way that ensures that responsibilities are defined clearly. Allocation of responsibility for failure in the provision of services is particularly critical. Clearly this will be one of a number of issues to be considered carefully at the next price control review.

Funding for the remainder of the current price control

BP notes that Ofgem considers that the costs of establishing any agency should be funded by Transco from the existing revenue allowance in the current NTS and DN price controls, and that it does not consider it is appropriate that any additional costs associated with the agency arrangements are passed through to customers.

Quality of service

BP notes that Ofgem considers that there should be no deterioration in the quality of service, and that the new arrangements should promote enhanced provision of these services. BP expects to see an improved service with agreed incentivised KPIs to monitor performance in order to minimise the potential for adverse impact on customers.

Key issues for governance

BP agrees with the Ofgem principles underlying the design of the new governance arrangements, that is;

- Non-discrimination – in particular with regard to Network Code modifications
- Transparency
- Inclusiveness
- Effectiveness
- Efficiency

We now provide our comments on the specific options;

Option A: NGT's initial proposal

The agent would be responsible for the provision of services such as SPA and the calculation and issue of transportation invoices. They would not be responsible for cash collection. Transco would retain responsibility for Network Code governance. The networks would be responsible for distribution charging development.

This option would give the agency the minimum responsibility. Network Code governance remains with Transco. There would be potential for Transco to show favour to the retained DNs in the modification process. As the agency is not responsible for cash collection and credit management there are also cost implications associated with individual credit arrangements for the separate networks.

Option B: Introducing a Governance Entity

This option would see the creation of a Governance Entity to oversee Network Code modifications and pricing methodology changes. This option is split into Option B1 where the network owners administer the credit management and cash collection functions and Option B2 that incorporates these activities into the agency.

Option B1 would result in shippers incurring additional costs in obtaining credit agreements with individual networks. Option B2 would therefore be BP's preferred option in this scenario as the agent would be responsible for the cash collection and credit management, removing the need for additional shipper administration and costs. System development would be minimised as the agency would be responsible for cash collection.

Option C: Including AT-link and RGTA in the Agency

Option C would bring the RGTA and AT Link systems into the agency. Credit cover and cash collection would be administered by the individual networks.

BP sees the advantage of bringing the RGTA and AT Link systems into the agency as this would reduce the risk of fragmentation and hence additional costs to shippers. Management of these systems would be controlled by the agency. The benefit of this is the single point of contact for all systems and the controlled roll-out of system enhancements. As with Optiona A and B1, cash collection and credit management remain with the individual networks adding to costs incurred by shippers.

Option D: Allocating systems with responsibilities

This option would see the creation over time of new a gas settlement system that would be managed by the agency. NGT and the DNs would also develop new systems to manage operational data such as gas nominations. These systems would replace RGTA and AT Link systems.

BP does not view this option as viable since the shipper costs of developing new interfaces and systems to handle gas nominations and settlements would be extremely high. These costs would likely be passed onto customers by shippers.

Option E: Including RGTA systems with the NTS and AT-link with the agency

As well as SPA, the issue of transportation invoices and related processes, Option E sees the NTS responsible for RGTA systems and the agent responsible for AT Link systems.

Although this option would give some stability to system development there is still the risk of fragmentation and associated costs. As with Options C and D, the cash collection and credit management functions remain with the individual networks. The benefit would be the management of the IT systems being managed by the agency. The individual networks would still be responsible for developing their own charging methodologies. This could in time lead to a complex pricing structure that shippers would need to maintain.

Option F: Broadest agency

This option incorporates the connection and metering activities into the agency as well as cash collection and credit management. It also sees RGTA and AT Link systems remaining within the agency.

This option gives the greatest amount of stability to shippers, since the agency would be the single point of contact for the vast majority of processes. Costs would be minimised as shippers would have a single point of contact for a wide range of services. BP recognises that this option could hinder the incentive for development but there is a view that this may be out-weighed by the cost savings that could be made.

Network Code and charging methodology governance options

Two options are being considered. The first option (Unrestricted governance) operates the governance arrangements as they exist today. The Authority would consider modification proposals against the relevant objectives of the Network Code. The second option (Restrictive governance) would include all the checks and balances as carried out in the first option but would also require the Authority to consider the costs of potential industry fragmentation. BP understands that the second option was considered by the workgroups and dismissed, but believes that there is merit in including an assessment of fragmentation issues. It would be helpful if the issues could be more fully explained, perhaps at the open seminar suggested earlier in this letter.

Oxera Research

Ofgem will be aware that the Gas Forum commissioned an OXERA Consulting study to present an independent assessment of the costs and benefits associated with the different agency options. The study comprises an assessment the main elements of the potential costs and benefits that should be analysed as part of a full RIA. BP understands that a copy of the study will be made available to Ofgem.

Oxera concludes:

“The analysis conducted by OXERA has combined qualitative and quantitative assessments of the costs and benefits associated with different proposed agency options. A summary of these costs and benefits is provided in Table 7. From the results it is possible to draw several conclusions:

- the costs to shippers increase substantively with full fragmentation implying an agency arrangement is a necessary component of any future regime;
- shippers anticipate the costs associated with a narrow agency to be significantly higher than those of a broad agency, due mainly to additional ongoing costs of dealing with

data quality issues, account management and additional regulatory and governance issues;

- the detrimental impact on total DN cost savings of a broad agency, assuming the agency cost figures used in the analysis, is outweighed by the higher shipper costs and the risk to competition associated with a shift to a narrow agency."

Oxera adds that:

"By providing a purely qualitative assessment of the agency impacts, the Ofgem RIA fails to highlight the full impact that alternative agency arrangements may have on the overall net benefits that can be achieved from the DN sales. In order to understand the ultimate impact on consumers, it will be necessary to compare actual cost and benefit impacts of the different options. This requires both detailed cost data from shippers and a clear definition of what constitutes the cost base of the agency under each of the proposed options."

Conclusion

BP can see the benefits associated with Option F; however, we do recognise that in practical terms it may have competitive disadvantages. Perhaps some further calculations could be carried out to more accurately measure the costs relative to the benefits. If this option proves not to be a realistic one, BP's preference would be for Option B2 since it includes cash collection and credit management within the agency framework. In addition, both RGTA and AT-link remain within the same organisation.

BP notes that Ofgem's initial view is that Options B1 and E have significant merits over the other approaches considered. Whichever option is selected, the potential for fragmentation associated with a DN sale must be addressed and satisfactorily resolved.

There is much work to be carried out over the coming months to develop the detail of the operational, commercial and regulatory framework to support a divested industry structure and BP hopes to be able to actively participate in this.

I hope that you find our comments helpful, and please do not hesitate to contact me if you wish to discuss any aspect of this response.

Yours sincerely,

Beverly Ord
Regulatory Affairs