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Dear Sonia,

**National Grid Transco – Potential sale of network distribution businesses  
Allocation of roles and responsibilities between transmission and distribution  
networks – 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 allocation of roles and responsibilities, we would first like to make some general points;

It is crucial that whichever option is selected, accountabilities must be clearly defined and customers must not be adversely impacted. BP supports the three key issues that have been considered when assessing the options:

- **Accountability and clarity** – an absence of accountability has implications for contractual complexity (requiring additional legal and technical resource), commercial and operational incentives (to secure efficient system planning and operation), regulatory costs and, ultimately, the costs borne by customers,
- **Security of supply** – if roles and responsibilities are not appropriately defined and allocated there is a risk that networks may not be efficiently maintained, developed and operated, which could increase the risks of insufficient investment and/or network failure, and ultimately result in costs to customers, and

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- **Scope for efficiency savings** – the allocation of roles and responsibilities between the NTS and DNs will have an impact on the level of efficiency savings available, and any loss of efficiency will ultimately have implications for the costs borne by customers. We note that the economies of scope and scale will vary depending on the individual circumstances of potential purchasers, and acknowledge Ofgem’s assurance that it will not allow additional costs associated with losses of economies of scale to be passed through to customers. We agree that it is desirable that roles and responsibilities should be allocated between the NTS and the DNs in such a way that retains the current advantages of the existing synergies associated with network planning and system operation.

BP highlights the following observations from the document:

- 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,
- There is no option representing “no change”. Ofgem is not considering the present arrangements as one of the options, and Option 1 has therefore been chosen as the base case.
- Each of the options in this RIA assign the role of gas balancing to the NTS, and in all cases the existing balancing regime, including the national balancing point, would be retained. BP supports this approach since it will assist in avoiding the introduction of additional complexity.
- There is no account taken in this RIA of additional costs to shippers or suppliers. Any such costs that may be identified through the development work to progress the framework over the coming months should be taken into account.
- The development of appropriate capacity and interruption arrangements on the NTS and across the DNs is currently being considered by the Commercial Interfaces workgroup.

### **Security of supply**

BP notes that, in Transco’s view, none of the options being discussed would jeopardise security of supply. BP also notes that the HSE will need to be satisfied under the Gas Safety Management Regulations that the option that is adopted ensures safety and security, and that the HSE has expressed the view that each of the options considered have the potential to comply with GS(M)R. However, none of the models have been developed in sufficient detail to determine whether safety and security requirements would be met, and there is much work still to be done in this area.

It is BP’s view that security of supply is a key issue, and one that warrants particular attention as the UK transitions from net exporter to net importer of natural gas.

### **Investment planning**

Transco’s annual planning process (Transporting Britain’s Energy), which informs their Ten Year Statement, takes into account both supply and demand data. Consequently it relies on data from the whole supply chain including both transmission and distribution networks. It is therefore key to ensuring security of supply that, whichever option for responsibilities for transmission and distribution networks is selected, there are clear responsibilities to ensure the support of the planning process.

### **Gas quality**

BP believes it is important that, whichever option is selected, it is robust and able to accommodate any future changes to gas quality specification for the UK transmission and distribution networks. Such changes might for example result from the work in which the DTI are currently engaged to review UK gas quality specifications. This ability to accommodate change will be important in the task of ensuring the UK’s future security of supply.

### **Interruption of customers/exit regime**

We understand that the issue of whether or not the NTS should be able to contract for interruption with shippers supplying gas to sites connected to DNs is currently being considered by CIWG. This, along with the issue of pricing arrangements for NTS and DN interruptions, should also be considered in the exit review and customers must be fully consulted on any proposals for interruption.

We believe it is important that, whichever option for roles and responsibilities is selected, it is able to accommodate fully any revisions to the exit regime that may in due course occur, and that in doing so, such revised arrangements can be applied seamlessly and without discrimination across transmission and distribution networks. BP welcomes Ofgem's intention to produce an RIA on exit reform.

### **Competitive impacts**

Ofgem has recognised that the sale of DNs and allocation of roles of responsibilities could, potentially, impact upon both wholesale and retail competition.

Wholesale competition – Ofgem states that, without careful management of the market and regulatory arrangements, there is a risk that the disposal of the DNs could lead to fragmentation of the NBP, which in turn could potentially reduce liquidity at the NBP and therefore hamper price discovery. Ofgem goes on to state that in turn, this could limit market entry, discourage trading and generally harm wholesale market competition. *In extremis*, nine such balancing points could arise if each DN were to insist that shippers balance on its individual network. BP is therefore pleased to see that Ofgem has proposed that the residual energy balancing role is retained by Transco as operator of the NTS, thus ensuring the retention of the NBP arrangements. BP is further reassured that the governance arrangements for the newly owned networks would not allow a new DN owner to develop its own balancing arrangements for its network without consultation and Authority approval.

Retail competition – Ofgem similarly 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. BP notes that these concerns are being addressed in the separate RIA on agency and governance, but we must ensure that customers are not adversely impacted.

We now provide our comments on the specific options;

### **Option 1**

Proposed by Transco and preferred by Ofgem, this option proposes a relatively active role for the DNs. The present gas balancing arrangements would remain with Transco acting as residual gas balancer.

With this option there would be a need to address the significant potential for fragmentation. We understand that this is being addressed through the separate RIA on agency and governance.

It has been proposed that a regulated offtake code is established to define and govern the operational and commercial relationship between the NTS and each DN, including DNs that are retained by Transco. This code would need to be effective and robust. Similarly, it would also be helpful to consider ways to ensure that effective and robust network co-ordination between the national control centre and the DN area control rooms will be achieved.

There may be loss of economies of scale with this option, depending on the location and operation of RDN and IDN area control centres, but BP notes that these costs will need to be factored into any purchase decision and that Ofgem will not allow these costs to be passed on to customers.

Since Transco will not be including DN control centre assets in any sale, there will be an interim arrangement whilst each IDN is establishing its own area system control centre, whereby Transco will use the Hinckley control centre to carry out system operation of the IDNs in accordance with an agency agreement known as the System Operation Managed Services Agreement (SOMSA). BP notes that this agreement will not be regulated by Ofgem. It is therefore crucial that the agreement is contractually robust to reduce the risk of failure to deliver by Transco (the retrospective compensation arrangements suggested may be inadequate). We also note Ofgem's observation that there may be some potential for discrimination by Transco in favour of its retained DNs, which could create costs for customers. Arrangements must be developed to prevent discrimination and to protect customers.

BP notes that the HSE has indicated that this option potentially provides a clear allocation of roles and responsibilities, which it considers is essential to demonstrating safety and security.

The greatest risk that must be addressed with this option is that a relatively active DN is more likely to seek industry fragmentation through diverging network code and charging arrangements.

## **Option 2**

This option gives a passive role to the DNs. Most key decisions would be made by Transco, who would retain responsibility for system operation and planning of the national network, including area control centre system operation and field operational responsibility across all DNs. Transco would need to enter into contractual arrangements with DNs for the provision of investment and maintenance. Transco would also need to determine whether to employ its own field operations units or whether to contract this function out to DNs. BP notes Ofgem's view that the contractual interfaces in this model are likely to be both significant and complex, and that the contractual complexity would result in additional costs being incurred by network operators. Ofgem also indicates that this model lacks accountability which could lead to difficulties in allocating costs and determining the cause of any network failure, an increased potential for disputes, misaligned commercial incentives, greater discrimination against IDNs by Transco and a reduction in the efficiency of operational decisions (since Transco SO would be responsible for issuing detailed operational instructions relating to a set of assets that it does not deal with at a local level).

BP notes that the HSE has indicated that under this option an IDN may find it difficult to demonstrate that the safe and secure operation of its network would be ensured when key decisions with respect to its network would be made by Transco SO.

It is difficult to see the appeal of this option to potential purchasers since most of the responsibility sits with Transco, however a passive role may suit some depending on their individual circumstances.

This option also appears to have the highest "loss of potential benefit" in relation to the other two options.

## **Option 3**

This is a hybrid model designed to allow DNs to be responsible for making their own investment and interruptions contracting decisions whilst having a single system operator control centre for all DNs (both independent and retained) that would be operated by Transco. Transco SO would operate both the Gas National Control Centre and the Area Control Centres and would issue detailed instructions to DN field staff on operational matters. As Transco would be responsible managing interruption on each DN, it would have access to the interruption contracts that have been agreed by the DN owner with customers/shippers.

BP notes Ofgem's view that lack of clarity regarding accountability for inefficient system operation or failure to develop and maintain an efficient pipeline system could lead to costs associated with contractual complexity, regulatory costs and misaligned incentives.

Although the DN would be responsible for contracting for interruption, Transco SO would be responsible for calling interruptions; BP notes that Ofgem considers that it would be more difficult to create meaningful economic signals at the NTS/DN interface. It would also mean that the offtake code would need to govern the relationship between a very much larger number of interface points than the 114 DN offtake points from the NTS (as occurs under Option 1).

BP also notes the higher potential for disputes relative to both Options 1 and 2.

With this option, contractual or incentive arrangements would need to be developed between Transco SO and each DN in order to allocate and share financial responsibility for the costs of interruption. NTS and the DNs would also be required to develop a set of detailed instructions to address a variety of potential operational scenarios.

BP notes that the HSE has indicated that it is not clear at this stage how the DNs or Transco NTS would be able to demonstrate in a safety case submitted under GS(M)R that the arrangements for co-ordination and co-operation under this option were sufficiently robust to ensure safe and secure operation of the system, because the nature of the interface arrangements which might operate between DNs and NTS under this model are not sufficiently clearly identified. BP also notes Ofgem's concern that the interruption arrangements could lead to potential problems that would give rise to greater security of supply risks.

BP has not considered Option 3a which was only briefly considered by the workgroups before being rejected.

## **Conclusion**

BP agrees with the suggestion that where there is lack of clarity and accountability in roles this could increase risks to security of supply. These are risks that must be avoided.

BP notes that Ofgem is minded to support Option 1. Whichever option is selected, the potential for fragmentation associated with a DN sale must be addressed and satisfactorily resolved. Ofgem itself recognises that the potential for fragmentation may be greater with Option 1 than with the others.

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**