



Beverly Ord



BP Energy
Witan Gate House
500-600 Witan Gate
Milton Keynes
MK9 1ES

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Sonia Brown
Director, Transportation
Ofgem
9 Millbank
London SW1P 3GE

Direct: 01206 752019
Main: 01908 854072
Mobile: 07799 740739
Email: ordba@bp.com

Dear Sonia,

**National Grid Transco – Potential sale of gas distribution network businesses
Offtake arrangements – Regulatory Impact Assessment (RIA)**

Thank you for the opportunity to provide views on this RIA. BP's response is not confidential and may be placed in the Ofgem library and on Ofgem's website. In making our comments we have separated our contribution into general and specific comments.

General

In our opinion this RIA, along with the two earlier DN Sales RIAs for Agency & Governance Arrangements and for Roles and Responsibilities, lacks detailed information on costs and it will be impossible to fully understand the costs and implications until more detail has been developed in the workgroups. As indicated by Ofgem, this is a high level document and a significant amount of work needs to be undertaken to develop the detail on the options. By definition, it is therefore not possible to provide detailed comments on all the options proposed. Consequently, it would be of assistance for interested parties to understand from Ofgem what level of assurance they can provide to customers that the most appropriate option(s) will be selected for further consideration and development, should Ofgem choose to undertake selection on the basis of the high level information currently available and in the absence of full detail that has still to be developed.

The scope of this RIA includes consideration of fundamental change. It is therefore, in our view, vital that customers are fully engaged in the process. We are aware of some customer participation in workgroups, and the fact that the consultation is open to all via Ofgem's website, but considering the nature of these proposals it would seem appropriate that all interruptible customers are proactively informed of the proposals and their views sought. It would therefore be useful to understand the level of communication undertaken by Ofgem, and the statistical significance of the number of customers engaged. In addition, we believe that a series of customer workshops might usefully complement this consultation process. Achieving widespread customer participation would, we suggest, contribute positively to The Authority's principle objective of protecting customers' interests.

BP Energy is a trading name of
BP Gas Marketing Ltd
Registered in England and Wales No. 908982
Registered Office:
Chertsey Road
Sunbury on Thames
Middlesex
TW16 7BP

BP Energy is a trading name of
BP Oil UK Ltd
Registered in England and Wales No. 446915
Registered Office:
Chertsey Road
Sunbury on Thames
Middlesex
TW16 7BP

We note that a related RIA on Interruption Arrangements has recently been published with a closing date of 28 July for responses. There has therefore been little time to consider this closely related document, which references the Offtake RIA on a number of occasions. It is our view that there may therefore be benefits to be gained from Ofgem considering responses to the Interruption RIA before making decisions in relation to the Offtake RIA (which Ofgem indicate they wish to do by the end of July).

We would hope that Ofgem's final RIA, which will consider the total costs and benefits of NGT's planned sale of one or more of its DN businesses, will include more meaningful information that will enable all parties to more accurately assess their expected costs. It would also be helpful, as mentioned in our responses to the earlier RIAs, to hold an industry seminar on the DN Sales process; perhaps customers could also be invited to attend. The Gas Forum has also asked that Ofgem provide a detailed project plan for the DN Sales process to enable all participants to better plan and manage their workload and their systems and process changes in order to minimise both operational and financial costs; BP supports this request.

Before commenting on the specific options for offtake arrangements we would take this opportunity to note that whilst offtake and exit reform are closely associated with the DN separation and sale process, and that compatibility is required, fundamental reform of offtake/exit is not a prerequisite for DN sale or separation. We believe that any reform of offtake should be conducted with this fully in mind.

We now address the various options for the commercial and regulatory arrangements to apply, particularly at the NTS/DN interface, to address different ownership and the potential for undue discrimination;

NTS Exit Capacity and Rights Allocation

Ofgem identify the following four options;

- Option 1 – Transco's initial proposal
- Option 2 – NTS connects booking model
- Option 3 – Shipper booking model (with DN "top-up")
- Option 4 – Shipper booking model (without DN "top-up")

In the RIA Ofgem state that one of the key issues to be considered when assessing the options for offtake arrangements is security of supply. However, in the assessment of the options for the allocation of NTS exit capacity contained within the document, within the costs and benefits analysis, security of supply is not assessed. We therefore believe it would be beneficial to the debate for Ofgem to provide further detailed assurance relating to the safeguarding of security of supply, particularly when (as was noted at Transco's TBE seminar on 8 July) a tightening supply/demand balance position in the UK is predicted. We also note that the effect on competition has not been assessed in this RIA.

It is interesting to note that Ofgem indicate that for reasons associated with the timescales of DN separation/sale, an interim option may need to be selected for practicality. If this becomes the chosen route, then it would seem wholly appropriate that all the additional costs that would be incurred for this reason are covered by Transco or by the potential purchasers of DNs, not industry participants or customers.

With reference to the cost/benefit analysis, the figures quoted are stated to be indicative estimates based on high-level assumptions. Significant benefits are, for example, suggested under the category of 'No undue discrimination between networks'. In order to further validate these figures it would be of assistance if Ofgem were to provide detail of the discrimination that it is implied that the options will remove. Similar detailed supportive evidence in relation to figures suggested against other categories would also serve to inform the debate.

It is our view that further detailed information is required to permit participants to form a view and that selection of options should not be made on the basis of indicative estimates based on high-level assumptions.

With reference to the selection of Option 1 as the base case, we believe it is important that there is also an understanding of the overall level of costs that would be incurred in changing from the true current status quo. We believe that it would be beneficial to develop these costs and to publish them. Whilst “no change” may not be an option, we believe it important to identify and separate costs associated with DN separation/sale from those associated with other offtake reform not directly required to facilitate the DN separation/sale process.

With reference to Option 4, we understand that the 1 in 20 obligation would be removed from the DNs. If this were to be the case, on the basis of the high-level information available, it might appear that each shipper would need to develop their own planning process in isolation, which could result in multiple shipper plans needing to be aggregated. This would appear to raise the possibility of inefficient duplication of effort and the possibility of a lower-quality aggregate forecast by virtue of shippers being unable to see the ‘bigger picture’, leading to possible fragmentation or lost opportunities for efficiency that might be gained from considering the effects of diversity.

Ofgem refer to a three-year lead-time for NTS investment. We believe that many customers’ gas supply contracts have durations of around one year, and that the majority will be of less than three years duration. Shippers will, we believe, tend towards booking exit capacity to meet customer requirements rather than, for example, purchasing a long-term exit capacity portfolio and then securing customers to ‘fill’ this capacity. In order to provide the long-term investment signals that Ofgem seek, it would therefore appear that a change would be required in customer behaviour. It would be helpful to understand further details of how Ofgem have gained assurance for each option with respect to the probability of long-term signals being generated. Efficient network planning is a key factor in achieving future security of supply.

Overall, from the high-level information available, Option 4 appears theoretically to offer the greatest flexibility. The downside of this is that this option is likely to be the most complex and costly to implement and administer. It would be useful to understand further detail from Ofgem relating to this balance between flexibility and complexity, and the methodology used to select the appropriate trade-off.

Diurnal Storage and Operational Flows

Ofgem identify the following two options;

- Option A – Administered approach
- Option B – Commercial approach

Whichever option is chosen, it is of paramount importance that the physical security of the system is not detrimentally impacted. In addition, we reiterate our earlier points relating to the need to develop costs beyond the indicative level in order to better facilitate the selection of the most appropriate option.

Business Separation

Ofgem identify the following three options;

- Option 1 – Transco’s proposals
- Option 2 – Structural separation
- Option 3 – Legal and structural separation

In the event that NGT decide to sell one or more of their DNs, the purpose of business separation would be to mitigate the risk of undue discrimination by Transco between IDNs and RDNs. Ofgem has recognised that any DN sale would give rise to different commercial incentives for Transco, and concerns that current arrangements would no longer be appropriate; also that any commercial advantage conferred upon its RDN business to the detriment of the business of an IDN would ultimately adversely impact customers. It is

important to avoid unnecessary and increased regulatory complexity that could arise from Transco's proposal for 'targeted rules and licence conditions'.

Information, operational and physical separation would need to be fully assured, but only legal separation would lead to the additional assurance that would be provided by separate accounts with a clear audit trail and clear definitions on where legal obligations reside. It also creates transparency, promotes robust corporate governance and ensures that licence conditions apply equally to all DNs in practice.

Having considered the options presented in this RIA, BP has reached the conclusion that full legal and structural separation (Option 3) would best mitigate any risk of undue discrimination and allow RDNs to operate on the same basis as IDNs.

BP agrees with Ofgem that any implementation costs associated with restructuring Transco's business should not be passed through to customers. As Ofgem state, these costs would arise as a consequence of Transco's commercial decision to sell one or more DNs (IDNs will no doubt incur their own set-up costs and we would not expect these to be passed on to customers either). If any interim steps are taken, for instance as Ofgem suggests under the options for allocation of NTS exit capacity, then customers should be protected from the full cost of transition to the final position.

We have considered Transco's position with regard to debt restructuring and are not convinced that Transco would be at any disadvantage to any potential future owners of IDNs. We agree with Ofgem that potential effects on Transco's cost of debt should not influence the decision on separation.

BP notes that there will likely be ongoing costs for operational expenditure that may be passed on to customers, and that Ofgem will be considering these further through DISG meetings. BP will be following the progress of these discussions and expects that customers would be kept fully informed of developments.

Governance of the arrangements

Ofgem identify the following two alternatives;

- Governance under Transco's Network Code (or an alternative inclusive code covering all offtake arrangements)
- Offtake Code

BP agrees that it is essential that the governance arrangements are robust enough to ensure that they can evolve efficiently and effectively; and that arrangements should be clear and efficient.

There is insufficient detail in the document to wholly support either of the alternatives presented; BP's view would depend very much on the content of the proposed Code(s). However, as a general principle, if the content was relevant to shippers and had an impact on them either directly or indirectly, we would want to be in a position whereby we are able to propose modifications to the arrangements.

Conclusion

There will be much work required to develop the detail of these options in the workgroups, and BP expects that Ofgem will take full account of input from industry participants and from customers when making its policy decisions relating to the commercial and regulatory arrangements.

We note that significant input will also be required in a number of areas to define arrangements for a range of additional issues before the offtake arrangements can be completed; these being connection facilities, safety and emergency, measurement, maintenance, gas quality, liabilities and exchange of information.

We hope that you find our comments helpful. Please do not hesitate to contact me if you would like to discuss any aspect of this response.

Yours sincerely,

Beverly Ord
Regulatory Affairs