



**National Grid Transco – Potential sale of network
distribution businesses**

Offtake Arrangements

Regulatory Impact Assessment

A Response by British Gas Trading

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EXECUTIVE SUMMARY

This document comprises the British Gas response to the RIA on Offtake Arrangements. As we have previously noted, the series of sub-RIAs on aspects of the future regime form only a part of the picture, and hence we expect to comment further when the consolidated RIA is available.

We have a number of concerns with the proposals contained in the document, and are disappointed that Ofgem appears to discount work previously done in the industry in some areas, such as diurnal storage.

In a number of areas, we believe that the proposals have the potential to impact adversely competition between shippers, and hence could be detrimental to the efficient functioning of the energy market. We also consider that Options 3 and 4 (Exit Rights Allocation), in particular, have the potential to lead to either inefficient reinforcement or a deterioration in Security of Supply.

In addition to the specific points raised, we continue to have concerns with the management of the project in general, especially the lack of a detailed project plan and timeline. Unfortunately, we also believe it is necessary to reiterate our previous concerns with respect to the RIA approach chosen. Ofgem has again elected to exclude the no change scenario from the options for consideration, and has selected a base case for comparison, without evaluating the costs of getting to the base case. As we have previously explained, we believe that this approach reduces confidence in the remainder of the cost benefit information provided, and we would request that Ofgem remedies this in the consolidated version of the RIA.

In respect of the various proposals contained in the document, we support Ofgem's view that Option 3, full legal, physical and structural separation is required between the NTS and the RDNs.

However, we do not support Ofgem's proposals in respect of the allocation of Primary Exit Capacity Rights or Diurnal Storage.

In the case of Primary Exit Rights, we believe a variant of Option 1 (Transco's initial proposal) would be appropriate, namely a continuation of the current process as described in the document. With regard to Diurnal Storage, we again favour a variant of Transco's original proposal, Option A, in that we would like to see an administered allocation of Secondary Rights, with an administered, reasonably cost-reflective value attached, calculated as a result of a simple and transparent methodology.

In addition to the above concerns, we believe there are a number of areas in which it would be beneficial for Ofgem to provide additional information at this stage, for example, how Ofgem would prevent Opex resulting from separation being passed through to customers.

INTRODUCTION

Following on from our responses to the sub-RIAs published in April, British Gas has reviewed the contents of the RIA on Offtake Arrangements.

As we noted in our previous responses, whilst we appreciate Ofgem's reasoning behind publishing RIAs on sections of the potential arrangements, we remain concerned that the need to respond in isolation will reduce the quality and effectiveness of the consultation process. In particular, there is a significant interaction between those RIAs addressing arrangements for Offtake and Interruption. We remain strongly of the opinion that when Ofgem has drafted the consolidated RIA for submission to the Authority, it would be beneficial to issue it to the industry for consultation. This would ensure that participants are consulted on the overall shape of the regime and the full cost benefit analysis, once all the information is available. In the absence of such consultation, British Gas is of the view that the consultation process would have to be viewed as incomplete and, therefore, potentially flawed.

This document forms British Gas' response to the above document. However, we wish to caveat our comments, in that our views are subject to change once the consolidated RIA is available for scrutiny and the overall shape of the regime is known.

The document is in a similar structure to our previous responses, including general comments first and then specific points. The specific points are divided into sections to reflect the structure of the consultation document. Where we have observations to make on the Appendices, we have included them in the relevant section.

GENERAL ISSUES

1) Consultation on the Full RIA

As per our previous responses and the introduction, we are strongly of the opinion that it would be beneficial for Ofgem to consult upon the consolidated RIA prior to its submission to the Authority, though we are disappointed that insufficient time has been built into the programme to enable that to be likely ahead of the key July meeting.

We were, therefore, concerned to note that under the section on Way Forward (7.5 & 7.6), it is stated that the future RIA will be issued later in the DN sales work programme, by implication, after key decisions have been made.

2) Lack of aggregate cost/benefit information

Whilst Ofgem has provided some high level indicative information, which is helpful; in our view there is insufficient detail as to how the estimates have been arrived at, especially in relation to shipper costs. Whilst some assumptions have been documented, the reasoning underpinning the assumptions has not. British Gas is of the opinion that consultees would feel more confident in placing reliance on the figures if further explanation had been provided.

In addition, as in previous RIAs, Ofgem has not assessed the costs of achieving the selected base case, and therefore, we believe the relative cost information, which has been provided, has limited value as a basis for participants to respond.

3) Omission of the “no change” scenario

As in previous RIAs, Ofgem has omitted the no change scenario, selecting a possible way forward and then rating other options against it. Whilst we have noted Ofgem’s explanation that the RIAs are intended to consider alternative ways forward other than the status quo, we do not feel able to support this approach. The major reason for this is that in selecting the base case, Ofgem has elected not to quantify the costs of getting to the base case; hence the relative benefits of the various options are less meaningful.

In addition to the above point, as we have previously commented, British Gas is of the view that decisions of this magnitude are not “stand alone” and should not be made in isolation from each other. Such isolation may lead to a failure to consider either beneficial or adverse interactions, and hence the selection of a sub-optimal solution.

4) Transco’s GT Price Control

We note in the RIA Ofgem’s recognition that incentives on the DNs would be necessary. We do support this view, but given the complexity of the price control, we would encourage Ofgem to reconvene RAWG as soon as possible to begin consideration of possible ways forward in this area.

We have noted that previously, Ofgem has appeared reluctant to adjust the control. We would certainly support this approach in general, due to the impacts of regulatory uncertainty. However, we are of the view that the possible sale of the DNs is an event of such magnitude, that failure to re-open selected areas of the control could, of itself, be distortionary. In this light, we believe that, as well as creating an incentive regime for the DNs, it is likely to be necessary to reconsider some elements of the NTS SO incentives to ensure that the alignment between the NTS and DN incentive regimes produces the desired outcomes.

In considering the GT Price Controls and possible amendments needed, it will be important to recognise that the controls do not exist independent of each other. This means that not only would it be necessary to take account of interactions between the controls, but it may also be necessary to adjust between the controls.

In paragraph 2.63, Ofgem notes that separation of the DN Price Control will result in the gradual introduction of regional differences over a 25-year period. As British Gas has previously highlighted, we believe that regional divergence will occur much sooner due to the effect of separate K factors, potentially within a year or two. This is clearly also a view held by Transco, as evidenced by Pricing Consultation PC80. British Gas continues to be of the opinion that these differences would be exacerbated by the sale of Transco's Distribution Networks, and further, as Separation was viewed as a pre-requisite for the Sale process, the costs of separation should be included as costs of the DN Sales process. This would result in consistent treatment of costs and benefits, as the benefits ascribed to PC separation would not be available in the absence of DN sales.

5) Transitional Issues and Project Planning

British Gas continues to be very concerned about the lack of consideration given to transitional issues. If DN Sales proceed, the industry will need to make major changes to support the process. In some cases, with proper planning and sufficient notice, a hard cutover may be possible. It is more likely, however, that in some areas transitional provisions will be required, and in some cases transitional processes.

The RIA documents issued so far have considered costs and benefits of getting to the "new world", however, where transitional arrangements are required, these will also incur costs. In order to arrive at a robust cost benefit analysis for the project as a whole, the costs of such transitional provisions need to be included. It is worth noting that, as transitional provisions tend to be no more than a "stepping stone" on the way to a permanent solution, the costs incurred generally have extremely limited offsetting benefits.

As the workgroups to date have not considered transition mechanisms, it is not yet possible to quantify costs, and hence the RIAs will be incomplete. In many cases transition costs for major changes are significant, and if this were to be the case on this project, there is a risk that these costs could undermine the basis on which the Authority decision is made.

In addition to the above, British Gas supports the concerns expressed by the Gas Forum in respect of the absence of a clear project plan with key milestones, even though the actual timings attached would, at this point, be indicative. The lack of such a plan at this stage brings into question the ability of the industry to plan and schedule required changes to enable implementation to the desired timescale. We would also reiterate the point made by the Gas Forum in respect of resourcing, DN sales is not the only major industry change programme currently in existence, and it has to compete with other programmes for scarce funding and resource within shipper and supplier organisations.

Clearly, this project has received priority funding and resourcing within Transco's organisation, but it is natural that other industry participants may take a different view, especially given the current uncertainties and doubts about the net benefits and timing of the Sale process.

6) Security of Supply

Ofgem considers that an objective of the arrangements is to promote efficient signalling of investment requirements by customers, which may have the potential to improve security of supply. British Gas believes that the dual questions of the "right" level of security and where the obligation for maintenance is vested, are germane to this issue. We would contend that obligations relating to security of supply, such as the 1 in 20 obligation, should be vested in the price controlled, licensed, monopoly service providers.

Transferring such obligations to shippers, who are, quite properly, commercially motivated, is inappropriate, as the degree to which such obligations are met will depend upon the levels of diversification within individual portfolios and organisations' appetite for risk.

7) Competition

British Gas is supportive of the points raised by Ofgem in respect of the potential risks to competition due to fragmentation of network operations. We continue to have major concerns in this area, and would stress that the risks and attendant costs should not be underestimated.

We also believe that, at the present time, it is not possible to judge accurately or predict the total effects on competition. It is only when the full RIA is available, covering all key aspects of the future regime and including a robust cost/benefit case, that the true impact on competition will be visible. At that point, all parties will be able to respond fully to consultation, any representations made in advance of this will, of necessity, be incomplete.

SPECIFIC ISSUES

NTS Exit Rights Allocation

Consistency of approach

The allocation of capacity requires a consistent approach in order to ensure equitable access to both NTS and DN(LDZ) Exit Capacity. There is potential for a regime of unconstrained capacity allocation to DNs with only a constrained product being available to Users for the supply points in their portfolio if the relevant options are selected. Indeed, this would be the outcome if the options which Ofgem appears to favour were selected.

Option 1 – Transco's Initial proposal

Whilst we would agree that this proposal represents the closest regime to the present, we note that the changes required to implement this would not be insignificant. For example, at present Transco allocates NDM Exit Capacity, and books DM Exit Capacity on behalf of shippers, whereas the proposal entails shippers requesting SOQs by DM site or NDM zones by DN.

We are not clear as to the nature of an "NDM zone", and note that this change to Shippers' working patterns will entail costs and system changes to enable shippers to forecast their requirements, as well as significant changes to the Network Code and DN/Transco's systems to allow shippers to submit requirements on an ongoing basis. With this in mind, we believe that the costs of this option must be evaluated before assessing relative benefits of options 2-4.

Ofgem records concerns against this option on the potential for the NTS to discriminate between IDNs and RDNs, we believe that given Ofgem's preference for full separation, this concern could be adequately addressed by licence conditions and possibly incentives supporting separation. Equally, any tendency of DNs to overrequest capacity could be addressed via a carefully structured incentive scheme.

Option 2: NTS Connects Booking Model

Under this option, there are two variants proposed, the key difference being the absence of a financial relationship between the NTS and DNs under option A. We are of the view that from the point of view of simplicity, it would be preferable for shippers to have a single point of contact for their financial relationship, via the Agency, this would include issuance of all invoices and payment of all amounts.

The financial flows under option 2B appear contradictory; we do not support the proposal that shippers should pay the NTS for NEC overruns, for which they are later reimbursed by DNs. This transfers even more risk to shippers, and would necessitate DNs providing shippers with appropriate credit guarantees. As such guarantees would have to be provided on a shipper by shipper basis, for unpredictable amounts, this is likely to be a costly exercise for DN owners. If this is the option chosen by Ofgem, we would wish to be assured that DNs would not be permitted to pass such costs to customers via their allowed revenue.

In addition to the above points, this proposal assumes shippers will be able to request exit capacity directly should they so wish. British Gas is of the opinion that this is an unlikely outcome given portfolio uncertainties and the difficulties inherent in forecasting requirements up to three years in advance. We are of the view that only very marginal benefit could be available relative to the overall costs of the solution imposed, and further, that even this marginal benefit would be simply redistributed between participants with no net gain.

Should this option be selected, we believe that a robust incentive regime will need to be introduced at the same time. We also note that in the qualitative evaluation of benefits under 6.16, bullet point 2, Ofgem asserts that option 2 would remove the potential for undue discrimination by the NTS in the NEC allocation process. The paragraph continues “This view has been endorsed by the DISG and CIWG workgroups.” Whilst we agree that this issue has been raised in the workgroups, we would not support the view that it has been endorsed.

The ability for NTS connects and DNs to request capacity from the NTS does not, of itself, remove the scope for undue discrimination or deliver a framework for effective competition. British Gas is of the view that the key to a lack of discrimination between DNs/NTS connects is the use of a simple, transparent methodology in which Transco NTS may only apply discretion within certain clearly defined and documented boundaries. This could be achieved by appropriate drafting of licence conditions, reducing the need for complex processes; especially if Ofgem’s preferred level of business separation is implemented.

Option 3: Shipper Booking Model (with DN “top-up”) and Option 4: Shipper Booking Model (without DN “top-up”)

British Gas is of the view that both these models transfer significant extra risk to Shippers, though Option 3 does, at least, leave the 1 in 20 obligation with the price controlled, regulated, monopoly service providers.

We have a number of major concerns with both proposals, and are of the view that there are so many fundamental issues involved that these options should be excluded from consideration. These issues include transfer of capacity between portfolios (which could not be automated as it would defeat the object shipper of choice in the levels of capacity held or traded); the difficulty of forecasting firm capacity requirements 3 years ahead; barriers to entry and exit; placing small, non-diversified players at a disadvantage; a high risk of damage to competition; and an incentive for hoarding. We are of the view that a normal UIOLI regime would not work as it is not presently possible to prove whether or not a particular shipper is using their holdings due to the limitations of localised metering.

In addition to the points above, in respect of option 4, British Gas is strongly of the view that security of supply issues such as the 1 in 20 obligation should be vested with the relevant network operators, rather than commercially motivated entities with variable appetite for risk. Prudent shippers making adequate provision for their portfolio would be exposed to the consequences of under-booking by other shippers. British Gas is also concerned with respect to the possible interactive effects of a Shipper Booking Model when combined with an Active DN regime. An Active DN regime places DNs in control of their own networks with commensurate responsibilities and benefits.

If Options 3 or 4 in particular are selected, significant influence and control is removed from the DNs, which is likely to alter their perceptions of risk and reward available to them. We also consider that different DNs will have different appetites for risk and different levels of historical information available to them. This, combined with their perceptions of the commercial drivers behind shipper behaviour may lead to discounting of market signals and inefficient investment.

It is clear from the RIA that Ofgem envisages that shippers would be exposed to DEC (and, under option 4, NEC) overruns under this regime. Whilst we appreciate the reasoning that has led Ofgem to propose this, we do not believe that the capability to target these charges accurately is available for the same reasons as our comment above on UIOLI. The result of this proposal would, therefore, be the introduction of a non-reflective penalty. It should also be noted that incentives can only be judged robust if the incentivised party is able to respond effectively. In respect of exit capacity, with the exception of DM sites, overruns cannot be properly measured at a shipper level; neither can the outcome of actions taken.

The complexities inherent in both these models are such that the level of cost benefit information provided is wholly insufficient. If either option were to be selected, a considerable amount of development work would need to be done, followed by a full, independent and detailed RIA consultation process.

British Gas is of the view that both options 3 and 4 have the potential to weaken rather than strengthen investment signals; encourage large regional rather than national players and disadvantage small or niche players.

Preferred Option:

Given the timescales and degree of required change implied by the Ofgem decisions to date in other areas, British Gas is of the view that changes in the area of Offtake arrangements should be restricted to the bare minimum.

We would propose that Exit Rights should be allocated as now, possibly via the Agency, and that Shippers should not be required to take a more active role than they do now. This would be a variant of Option 1, where Shippers are not required to notify DNs of their requirements, instead, the DN or Transco NTS would make DM and NDM bookings on the shippers' behalf.

British Gas also believes that the responsibility for the 1 in 20 obligation for system capacity should rest with Transporters jointly on the NTS and the DNs, and that further the mechanism for calculating the 1 in 20 requirement should be fully documented and referenced in the licence, so that industry participants can be confident that all DNs and the NTS are working on the same basis. We would like to emphasise that, in our view, the importance of this obligation is such that no ambiguity of interpretation can be permitted.

Diurnal Storage and Operational Flows

Option A: Transco's original proposal

British Gas agrees that this option is closest to the current arrangements, though we believe that it would be possible to use a variant of this option and either apply an administered, reasonably cost-reflective price to each element of diurnal storage, or calculate an adjustment to ensure that the costs of provision are distributed appropriately across the NTS, IDNs and RDNs.

In respect of the costs and benefits propounded by Ofgem, British Gas is not persuaded that the assessment in the RIA is correct.

Under 6.28, bullet 1, it is unclear whether Transco's proposal of >90% of year 2 levels is intended to apply in perpetuity, or only until the next price control, neither does the document address how capacity withdrawal would be treated and compensated. We would also suggest that the concern raised by Ofgem in the last paragraph under this bullet (in respect of DNs being forced into making investments as a result of separate ownership), is a result of price control separation as much as DN sale.

Under 6.28, bullet 2, British Gas is concerned that the key consideration of promoting a framework for revealing capacity values is not qualified by considerations of cost. We would also question whether treating diurnal storage as an operator to operator product is an inefficient alternative, as the costs of alternatives seem likely to far exceed the quantifiable benefits. British Gas also believes that the majority of Ofgem's expressed concerns on

discrimination under this bullet could be addressed by a combination of business separation, explicit licence conditions and a published, transparent, allocation methodology. If implemented in combination, we do not believe that there will be any greater risk of dispute over allocations than exists now.

In respect of the security of supply points raised under 6.29, British Gas is of the view that the simplicity and minimal change inherent in Option A would support security of supply better than Option B, or another variant which would introduce further significant change at a time of industry stress.

Option B: Alternative, market based approach

British Gas has strong reservations about the proposed approach, we are of the view that the institution of market based arrangements for diurnal storage would introduce unnecessary and inefficient levels of cost/complexity for unproven benefits. The industry spent considerable time and effort in Review Group 513 reviewing the position in respect of Diurnal Storage, and concluded that the quantities available both on the NTS and DN were sufficient only to support the proper operation of the network. In the light of this work, we are concerned that Ofgem appears to discount the group's conclusions.

In Review Group 513, it was evident that there was insufficient Linepack/Diurnal flexibility to support a market based regime for all participants, though Ofgem indicates that a separate decision would be needed on whether the product was available to parties other than the DNs. If the product is available only to DNs, we believe that it is likely the costs would outweigh the benefits. If Ofgem were to decide that this Option should be implemented, we note that Ofgem considers that additional costs to the industry as a whole would be minimal. British Gas is not persuaded on this point as we believe that as well as costs of implementation, there would be significant re-distributive effects. In view of this, we would ask that Ofgem provide guarantees are provided that none of the costs of regime development or implementation will be passed to customers.

In respect of the costs and benefits identified by Ofgem, we believe that some key issues have not been addressed. One example of this is that the residual balancer currently has full access to all available Diurnal flexibility to balance the system. As this flexibility is finite, once allocated, (e.g. under a market based mechanism), the residual balancer may no longer have the product available, which may lead to increased balancing costs for all and reduced system security.

Secondly, as most Diurnal Storage is in the LDZ, presumably revenues associated with sale of this flexibility would be remitted to the DN, leading to a lack of clarity between DN revenues and reductions in SO Costs. This would need to be carefully examined and addressed via the price control and incentive regime. Considerable care will need to be taken in the design of the DN incentive regime to ensure that the DNs are not incentivised to discriminate either between customers or their peers. The interactions of the DN and NTS SO regime will also need to be reviewed to ensure that the DNs cannot operate in such a way as to damage or potentiate the NTS SO performance under its incentive regime.

Ofgem also notes that offtake rates would be enforced, or failure to enforce would lead to increased balancing neutrality smears. Whilst British Gas would agree that the adverse impact to neutrality is the likely outcome of the current regime when combined with a market-based mechanism, we consider that this would be non-reflective. If a Diurnal Storage product were only available to DNs, it would seem wholly unreasonable that the costs of the residual balancer's trades to correct DN deviation should be smeared across the shipper community via balancing neutrality. In addition to the above points, we are unclear how offtake rates would be enforced, what penalties would be applied and how the penalties would be accounted for.

British Gas also considers that Option B might easily lead to inefficient overinvestment as risk averse DNs seek to mitigate their exposure to the risks of not being able to obtain access to diurnal storage on their networks. Such over investment can only lead to inefficient reinforcement and unnecessarily increased costs to customers.

Preferred Option:

British Gas supports Option A, and would further recommend that the possibility of exploring a simple, administered price for the service between NTS and all DNs should be considered. We are also of the opinion that 6.32 exaggerates the problems created by DN Sale in respect of this particular issue, as we believe that most of these issues were created by the separation of the price controls. We are also of the view that the issues raised on Diurnal Storage could be successfully addressed by Business Separation and robust licence conditions.

Business Separation

Option 1: Transco's proposals

This option would enable Transco to continue its existing level of separation, with some additional safeguards being provided by licence conditions.

British Gas does not support this option as we do not consider that it offers sufficient protection for the IDNs, customers and other industry participants.

Option 2: Structural Separation

This option would incorporate a number of forms of separation including operational, informational and locational separation. Whilst we concur with Ofgem that this would offer improved protections for the industry as a whole, we believe that the issues at stake are so major that only full legal and structural separation will meet the need.

We note that in 6.44, Ofgem intends to ensure that capital costs are not passed to customers, and we support this principle, whether as part of Option 2 or our preferred Option 3. However, given that these costs may be significant, we would be concerned as to the incentives this might place on DN behaviour, and would welcome further information from Ofgem on how they would plan to implement this. We also appreciate the point in the second bullet of 6.44, that opex will be calculated in the ordinary manner, however, we believe it is possible that a Transco RDN may prove to be the frontier company, in which case, referencing RDN opex to IDN opex may not achieve a robust result. We believe that further safeguards may be required in order to ensure that customers are protected from these costs.

Option 3: Legal and Structural Separation.

Many of the detailed arguments in support of this option are contained in Appendix 2, which we have also reviewed in detail.

Since the commencement of this consultation process, British Gas has supported the principle of full legal and structural separation of the NTS and DNs. We continue to hold this view and support Ofgem's preference for Option 3.

British Gas supports many of the arguments presented in Appendix 2, but would welcome additional clarification on what is proposed. The main body of the RIA implies that what is under discussion is the separation of the NTS from the group of RDNs, whereas parts of Appendix 2

(e.g. 2.5 and 2.19) imply that consideration is being given to separating the RDNs from each other. British Gas would also wish to note that if the decision were made to separate the RDNs from each other as well as from the NTS, equivalent restrictions would need to be put in place on any DN purchaser acquiring more than one DN.

Whilst we believe that the NTS must be fully separate from the group of DNs, we are less sure that the additional benefits achieved by separating the RDNs from each other would outweigh the associated costs. It is possible that a good proportion of the benefits could be achieved by robust regulatory reporting and behavioural remedies, and prior to initiating RDN separation; we believe that a detailed cost benefit analysis of the additional benefits would be needed.

Preferred Option:

British Gas believes that Option 3, Legal and Structural Separation of the group of RDNs from the NTS, is the most appropriate way forward.

If Ofgem is considering requiring further RDN separation, we believe a separate consultation on the costs and benefits would be required.

Comments on Appendix 1

British Gas has some concerns with the material contained in Appendix 1; we have listed the issues below identified by the original paragraph reference.

1.2 Whilst we appreciate that quantification of costs and benefits is inherently difficult, we are of the view that if the costs of getting to the base case for comparison had been explicitly quantified, the remaining comparisons would be both simpler and more meaningful.

1.4 We would dispute that shippers currently request Exit Capacity, NDM Exit Capacity is allocated by Transco on Supply Point ownership and DM Exit Capacity is revised monthly by Transco on Shippers' behalf using a monthly snapshot on the 10th of each month. The exception to the above being the booking of interconnector capacity.

In addition, we are not persuaded that shippers wish to participate more actively in the acquisition of NTS Exit Capacity. The difficulties in this area are enormous due to the lack of measurement capability to target costs and penalties to the correct participant. Given the degree of estimation that would be involved to construct a regime from the current starting point, we do not believe that the resulting allocation of either costs or product will be any more accurate than the current regime.

1.4 – 1.9 We would also challenge Ofgem's view that there would not be any significant incremental IT/IS costs associated with any of the options presented in this document. British Gas is of the view that the magnitude of some of the changes proposed is such that significant systems development cannot be avoided. Unfortunately, discounting these potential costs damages the credibility of the information which supports the analysis of costs and benefits.

In our opinion, the changes proposed here are not bolt-ons or complementary to the existing systems, they would create a new market requiring new systems and processes, this is unlikely to be cost neutral, far less generate a net benefit.

1.13 More clarity is needed on the assumptions underlying the 2% figure quoted and the linkage between this 2% figure and the figures quoted in table A1.2, A 1.4 and several related paragraphs (such as 1.21, and paragraph 1.38 where a figure of 0.5% is mentioned).

1.28 and 1.32 British Gas is very concerned about the calculations referenced in these two paragraphs. We would appreciate further clarification, but at present we believe the comparison of reductions in balancing costs across gas and electricity may be invalid as the calculations appear to have been conducted on a different basis.

In paragraph 1.28 (gas), Ofgem has taken the total balancing neutrality “cost” to shippers and calculated 1% of this figure. Whereas in paragraph 1.32 (electricity), the reduction in balancing costs has been calculated using the reduction in cost of accepted offers plus the increase in revenue from accepted bids, which we consider to be a net position.

It is equally possible that changes to residual balancing activity may result in a reduction of actions resulting in payments to shippers and hence the comparison should be carried out on the net position. If 1% of the net gas balancing neutrality position were taken, this change would result in a reduced benefit (i.e. an increased cost) to the community.

Table A1.6 Ofgem attributes a reduction of £5.7m (in NPV terms) in electricity balancing costs to Option B as opposed to Option A in respect of Diurnal Storage. We are very concerned that benefits accruing as a result of the DN sale process should be directed to those customers and participants bearing the cost, to do otherwise would introduce an unjustified cross subsidy from gas into electricity. We would welcome clarification on how Ofgem will ensure that the financial benefits deemed to accrue are correctly attributed.

CONCLUSIONS

British Gas has appreciated the opportunity to comment on this document, which has made a helpful contribution in setting out possible options. Whilst we understand why Ofgem has chosen to present the analysis in this way (excluding aggregated cost information and the “no change” scenario), we are of the view that this has, unfortunately, significantly reduced the value of the RIA and resulting consultation.

In respect of the allocation of Primary Exit Rights, we support a variant of Transco’s original proposal (Option 1) as described above.

With regard to Diurnal Storage, we again favour a variant of Transco’s original proposal (Option A), in that we would like to see an administered allocation of Secondary Rights, with a reasonably cost reflective value attached, calculated as a result of a simple and transparent methodology.

British Gas strongly supports Ofgem’s preferred option (Option 3) for Business Separation, namely the full legal and structural separation of the NTS from the group of RDNs.

We have raised a number of questions and concerns in respect of issues arising in the document and would welcome further clarification in these areas.