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Dear Bruce,

BP is pleased to offer the following response to Ofgem's consultation "The economic regulation of gas processing services – key issues and initial thoughts". In addition to the more specific points addressed in the questions, BP would like to make the following general points.

BP considers that whilst focus on the health and safety issues relating to gas consumption is important, thought also needs to be given to the effect gas quality has on the traded market, given the increasingly interconnected nature of the internal gas market. The European Commission invited EASEE-gas to propose harmonised gas specifications for Europe to remove barriers to trade. At present, the UK has chosen not to implement the harmonised gas quality specifications discussed and recommended by EASEE-gas under the Madrid Forum and therefore to remain non compliant till at least 2020. The decision of the UK to be non-compliant will impact on liquidity because gas quality imposes a barrier to trade for the free movement of gas across Europe. At present adopting a wider gas quality specification in the UK is not possible due to the ageing appliance population; however, it may be more efficient to adopt other measures to ensure that the UK can accept a wider gas quality specification, which should not necessarily imply that the costs should be transferred to other parties.

The Commission has requested that CEN looks at the possibility of developing harmonised European standards for gas quality. There is a high probability that private investors will not underwrite investment to ensure compliance with the CEN standards due to uncertainty of gas sources and the subsequent gas quality. Therefore, there is a strong likelihood that responsibility will fall to the UK government to develop a workable solution.

BP also notes that Ofgem's document makes reference to the imminent DBERR consultation on gas quality and CEN's work on harmonised specifications. It therefore seems strange that Ofgem published its document ahead of the publication of these two. It is clear that gas quality cannot be dealt with in isolation and therefore a co-ordinated approach with the UK government and European Commission is needed.

In the interim, a solution needs to be found to ensure that at peak times, gas is not shut out of the system. One potential solution would be to allow short term gas quality excursions onto the system akin to that which would occur in a gas emergency.

We will now address the specific questions.

Q 3.1: To what degree can commercial incentives alone be relied on to deliver efficient investment in gas processing services? If not, what is a reasonable balance of risk between customers and users?

It is difficult for the commercial market to underwrite Investment in gas processing facilities due to the large amount of uncertainty surrounding the level of information. It is currently unclear if or when the UK might accept the harmonised gas quality specification that have been proposed via the EASEE-gas working group. The DTI has also yet to conclude whether the ageing appliance stock which is preventing adoption of the harmonised specification will be changed and if so the lead times associated with this outcome. This is directly related to the length of commitments that shippers will be prepared to sign up to and the economic viability of any investment. BP waits expectantly for the outcome of the DTI's (now DBERR) three phase study, which is due to be published soon. There is also great uncertainty surrounding the quality of future pipeline gas supplies, due to the import dependency of the UK and thus the UK's reliance on more diverse sources of supply going forwards.

Whilst BP considers that it is generally more favourable to leave the market to deliver the optimum solution, it is known that the market does not always address low probability/high impact events. Therefore, it is likely that left to the market a processing facility would not be built due to the high level of uncertainty surrounding supplies of gas and their corresponding gas qualities. There is merit in exploring all potential options and conducting a thorough cost benefit analysis. Despite the claims made by the Ofgem document, the regulated option has never been discussed and evaluated in any detail. BP finds it hard to accept that this solution would never work in practice without seeing the associated costs and benefits.

Given that a shortage of gas on a peak winter day could lead to huge costs that will be borne by industry and ultimately customers, a cost sharing option would be more beneficial. In BP's response to Ofgem's gas quality document published 30th January 2007, we endorsed UKOOA's view that investment by National Grid should be included in its regulated asset base and backed with 50% user commitment instead of the 100% that Ofgem deemed was necessary. The balance of capacity could be sold by regular auctions, right up to the day, enabling shippers to pay as they flow gas.

Q 3.2: would provision of gas processing services by NGG be the most cost effective approach? If so please explain why?

National Grid is in the unique position to understand and manage the daily gas flows entering its system. This therefore allows National Grid to be able to optimise between commingling and the ballasting of gas. There are a few processing facilities in the UK that have been built and financed by the commercial market, the majority of these are at LNG importation facilities, but as reported in the press recently, a ballasting facility has been built at Easington to deal with any Ormen Lange gas flows that are outside the UK specification. These gas processing facilities have been built at sites where sources of gas are known ahead of arrival and therefore there is certainty over gas quality specifications. Therefore, in the absence of certainty, National Grid would provide the most cost effective option for the provision of gas processing facilities.

Q3.3: If NGG involvement is essential to the provision of gas processing services, to what degree do existing arrangements ensure that NGG develops such services if they are demanded? What other arrangements, if any, would be more appropriate?

At present there are no obligations on National Grid to provide gas quality services if requested by the market. In Ofgem's previous document, it discussed the possibility of placing a new licence condition on National Grid to ensure that it would be obligated to undertake a feasibility study if requested to by market participants. Ofgem would also need to ensure that National Grid's charging is economic and efficient, cost reflective and would not operate as a barrier to opting into this service. It is important that this occurs because in effect National Grid would have a monopoly position in the provision of these services. It is also important to ensure that there is a route of appeal via Ofgem if shippers consider any of the charges levied by National Grid are unreasonable.

If after a cost benefit analysis, the fully regulated option is deemed to be the most cost effective option, changes would need to be made to National Grid's price control to take this into account.

Q 3.4: Given the existing market participants have already invested in gas import facilities including treatment of gas, how is the approach you favour consistent with preserving incentives for private investment in gas import and treatment facilities?

BP considers that it is important to treat gas quality on a case by case basis. Ofgem would need to determine whether Bacton represents a special case. BP can see arguments which would support this theory. One such argument is the problem with gas molecule tagging. In the absence of the application of the polluter pays theory, a second best option will need to be found. The lack of certainty is also a contributing factor. Given the inability for many market participants to forecast the quality of future piped gas sources, it is unlikely that market participants would be willing to invest in a processing facility and therefore if a partial or wholly regulated approach is not adopted, it is improbable that a facility will ever be built.

However, there is a balance that needs to be struck between preserving private investments and delivering security of supply. In an ideal world, costs should be targeted to the parties causing them, but in the absence of cost targeting, a model based on 50% user commitment should provide a happy medium between preserving private investments and providing a necessary insurance policy to UK consumers by securing supplies. Another hybrid model that could be considered would be for National Grid to require 100% commitment from users to ensure it can forecast accurately the required size of the facility, but the capacity offered to the market at 50% of the total price. The other 50% should be socialised.

Q 3.5: How much is the overall uncertainty attached to investment in onshore gas processing facilities is attributable to upstream issues, rather than future supply sources and demand.

BP considers that it is artificial to distinguish between future supply sources and upstream issues because they are inextricably linked. The uncertainty arises due to the lack of information from the continent as to the quality of future sources of supply of piped gas. Ofgem does not have the necessary remit in Europe to request publication of information regarding the long term supply portfolios of producers and the associated gas quality of the gas molecules.

Another source of uncertainty relates to whether the UK will adopt the EASEE-gas recommended specifications and if so when this will occur. Without certainty from DBERR regarding whether the UK will change its gas quality specification after 2020, shippers will be unwilling to invest in a facility that may become a stranded asset in the near future. Delayed adoption of the European gas quality specifications and concerns over security of supply should prompt the use of indigenous gas sources even if they are marginally outside of the UK specification by using blending on the system as a way to bring the gas within UK specification.

Q 3.6: Can commercial parties be expected to resolve the upstream barriers to the provision of onshore processing services, to exploit commercial opportunities? If not, what limits might there be to the barriers commercial negotiations might resolve and what is an appropriate role for Ofgem?

One thing parties could do is gas quality tracking. This would mean that each trade a party enters into across Europe, would have to be delivered and tracked within a certain specification until it enters the interconnector or the BBL pipeline. Whilst this is an option, BP considers that this should not be actively pursued because of the negative impact this would have on the traded market and in particular liquidity. It would also be very difficult to police this solution to ensure the gas shippers receive is within the stated specification in every trade.

The interconnector is unable to attach molecules to individual shippers because the gas it receives is a commingled flow from the Fluxys system. Fluxys as system operator of the Belgium grid may possess information regarding molecule tracking at Zeebrugge, however, the UK has no remit to acquire this data and therefore Ofgem's role in this regard is limited.

Q 4.1: How different do you consider the regulatory approach developed in the Economic Regulation workstream to be from a purely commercial approach? How important is it that NGG should be obliged to respond to market interest in gas processing facilities, as under the Economic Regulation workstream approach?

BP considers that the 'hybrid approach' as proposed by Ofgem, which requires the investment to be wholly underwritten by the market, does not represent a true hybrid option. This model is identical to a commercial solution with National Grid assuming the role of the infrastructure operator. Ofgem needs to undertake a detailed cost benefit analysis to understand the risks associated with pursuing this model versus the costs of a regulated solution.

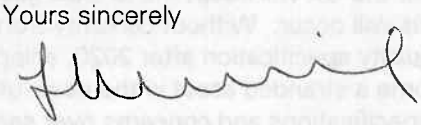
Q 4.2: Under a model based on user commitment, to what extent would enabling NGG to make additional investment in the service introduce costs? What are these costs and would they outweigh the benefits?

BP considers that National Grid would perceive that investing over and above the user commitment level to be against its interest. If National Grid secured user commitment for 100 units and it decided to invest in an additional 100 units, the market will have no incentive to book this capacity because it would know that it would be available on the day and therefore National Grid would not receive the certainty it would need to undertake the additional investment.

If under Ofgem's hybrid model market participants commit to 100 units of ballasting capacity, National Grid could decide to optimise the use of its system and build only 70 units preferring to manage the additional flows with blending etc. The vast majority of the time this scenario would have no impact on the market, however, there may be a situation where the absence of the additional 30 units may lead to gas being shut out of the system due to gas quality constraints. National Grid would have to pay a buy back cost to the shippers, but this would only cover the lack of available capacity, this would not cover the premium that shippers would have to pay to purchase gas on the OCM to make up this shortfall.

I hope you find our response useful, please do not hesitate to contact me on the above number if you have any queries.

Yours sincerely



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