



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

26 September 03

Kyran Hanks  
Director, Gas Trading Arrangements  
Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE

Dear Kyran

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

We thank you for the opportunity to respond to the above, and are pleased to contribute to the debate concerning these important issues.

Having considered the consultation document carefully, BP remains to be convinced at this point in time that the sale of one or more Distribution Networks (DNs) will result in benefits for customers. We have concerns in a number of areas which are summarised below

**TIMESCALES AND REGULATORY PROCESS STEPS**

In the consultation document Ofgem acknowledges that the timetable is "ambitious" and "slippage into 2005 cannot be ruled out". It is our view that the timetable proposed is extremely aggressive and unlikely to be achievable.

The changes proposed in the consultation are wide ranging and may be practically irreversible. Unless it can be clearly demonstrated that such an ambitious timetable is essential, we believe that a longer timetable should be adopted to ensure that full consideration could be given to these important issues, thereby reducing the risk of implementing inappropriate solutions. On the evidence available we do not believe a valid case has been made for taking increased risks associated with the timetable proposed.

We note that following this initial consultation, Ofgem intend to issue further proposals in November 03, and that these will include a go/no go decision. We do not believe the proposals are sufficiently developed for such a decision to be made at that time.

We believe that there is much industry debate to be had, and detail to be worked out, before a commitment can reasonably be made to a separation/sale of a DN. It is our view that it is imperative that the industry does not rush ahead and commit to something which, if it doesn't work, will be expensive (if not impossible) to reverse. One of Ofgem's stated objectives and principles is that *"the arrangements should not preclude future reforms that may improve the economic and efficient operation of the gas pipeline system..."*. If the sale of DNs is irreversible then future reforms may be precluded.

We suggest that the next stage of the process should be to decide whether or not to proceed with more detailed industry discussions and subsequent further industry consultation, and that no commitment beyond that be made until there is a clearer understanding of the likely impacts, costs and benefits of the proposal.

In addition we believe it is important that within any proposals for DN sale, NGT are clearly accountable and incentivised to deliver any milestones or objectives that may be set under the Gateway concept as conditions of separation/sale of a DN. In particular we seek assurance that NGT would remain accountable for any non-delivery of such milestones or objectives following sale.

## **REGULATORY IMPACT ASSESSMENT (RIA)**

BP welcomes the utilisation of RIAs in the consultation process.

In this particular case, Ofgem have undertaken a preliminary RIA, which indicates that over the period of 3 price controls (15yrs), reduction in controllable costs could be approximately £330m. It is stated that this equates to 1.3% of controllable costs. However, no detailed information is made available of the calculations behind this assumed 1.3%, its appropriateness to these particular circumstances, or any sensitivity analysis to help understand the likely financial impacts of the risks to the proposal.

In BP's view the preliminary RIA is not sufficiently developed to permit a sound decision as to whether to sanction the sale of a DN. We urge Ofgem to further develop the RIA to reflect the wide variety of options presented in the consultation, and then undertake further industry consultation before making a go/no go decision on the separation/sale of a DN.

When developing the suggested final version of the RIA, we believe it is important that full account is taken of additional costs that will be incurred by shippers, suppliers and customers, in addition to those costs incurred by NGT. Only then can a fair assessment be made of whether customers' overall costs are actually likely to fall as a result.

When considering detailed cost implications it is important to consider all the costs shippers would incur, which include costs during the development phase (regulatory cost, internal impact assessment, systems development/modification costs etc.) as well as ongoing costs under a proposed new regime (extra costs of managing multiple accounts etc). Within this analysis it should be recognised that IT implications are significant, particularly should the change be linked to an ambitious timetable. This we suggest was the case for the costs of Metering Competition, which is being introduced with an overly ambitious timetable leading to significantly higher IT expenditure.

With reference to the overall structure and content of the RIA, BP believe that it is essential to separate out areas of potential reform which are not actually essential elements of a proposed separation or sale of a DN (e.g. Exit reform), but which have been bundled together with the DN separation/sale issue. Only then will the true value of DN separation/sale be discovered, as costs and benefits of these non-essential elements cannot reasonably be considered as attributable to separation/sale of a DN. The non-essential elements could of course continue to be considered in their own right and be subject to their own separate RIA.

Furthermore, we believe it is important also to separate out the costs and benefits associated with separation of a DN, as distinct from the sale of a DN. Only then can it be

clearly understood whether for example a sale would deliver any benefits over and above separation alone.

## **COMPLEXITY**

We note that Ofgem recognise that "complexity for shippers and customers" will need to be addressed, but their initial view is that NGT's proposals "should be beneficial for customers". In order for BP to gain assurance that this will actually be the case, we believe that it would be helpful if Ofgem were to share the analysis that was utilised to reach this initial view.

Our view, on the evidence available at present, is that in many areas the proposals include fundamental change that will add complexity (e.g. in processes, contracts, systems) and in some areas will have no effect on complexity. However we are yet to identify any areas in which there will be greater simplicity for customers, shippers or suppliers.

We therefore suggest that the sale of a DN could actually hinder supply competition by increasing complexity.

## **RESOURCE REQUIREMENTS**

In the consultation document Ofgem recognise that the proposals constitute a fundamental change to the structure of the gas industry and that significant work will be required to understand the detailed implications of any DN sale. We understand that Ofgem believe that this proposal would require a significant proportion of their total resources and would therefore urge Ofgem to assess carefully the actual amount of resource that will be needed by undertaking further development of the proposals prior to making a commitment.

Regulatory resources are finite and are currently stretched across all parts of the industry. The resource requirements of this proposal must be prioritised against other possible needs for resource.

It is BP's view that at the present time, security of supply related issues (long and short term) particularly should be prioritised higher than the consideration of DN separation/sale. It is our view that only when Ofgem are confident that adequate resource will be available to address security of supply issues, should consideration be given to allocation of resource to this proposal. In addition there are a number of other key areas of work already ongoing against which the resource requirements of this proposal need to be prioritised by Ofgem (e.g. RGMA project, Customer Transfer Programme, SPAA development).

## **COMMENTS RELATING TO SPECIFIC AREAS OF THE PROPOSAL**

In addition to the above comments, please find comments relating to specific areas of the consultation document in the appendix attached to this letter. We would emphasise that these comments constitute only a few examples of the number of detailed issues, which in our view it is more appropriate to address in subsequent stages of the regulatory process.

For the avoidance of doubt, the attached comments do not infer BP's support for the separation/sale of DNs to proceed.

## **SUMMARY OF BP'S VIEWS**

It is BP's view that Ofgem should not at the present time sanction the sale of one or more of NGT's Distribution Networks.

On the basis of the evidence presented at this time, we remain to be convinced that there is a valid case for DN separation or sale, and that significant further work is required to understand the full cost implications and benefits for customers before any such decision should be taken.

It is currently our view that the proposals will only add complexity to the industry, which we suggest is not in the best interests of customers in the absence of clearly articulated benefits which outweigh the additional complexity.

Furthermore we believe that it is essential to separate out areas of potential reform which are not essential elements of a proposed DN separation or sale (e.g. Exit reform) but which have been bundled together with the DN separation/sale issue. Only then will the true value of DN separation/sale be revealed.

We also believe that DN separation should be considered separately from DN sale, to provide a clear understanding of the merits of each step, in order to permit Ofgem to decide whether to sanction DN separation alone or both DN separation and sale.

We trust that the above comments will be of assistance in compiling your initial views. Our response is not confidential and may therefore be placed in Ofgem's library and on Ofgem's website. Please do not hesitate to contact me should you wish to discuss the contents of this letter further.

Yours sincerely

David Slack  
Regulatory Affairs

**Appendix - BP's comments on specific areas of the consultation document: NGT – Potential sale of network distribution businesses**

## **GOVERNANCE ARRANGEMENTS**

The separation/sale of a DN raises significant issues concerning governance and BP strongly supports NGT's objectives for governance arrangements (4.52).

BP's preference would be for Option 1, the Uniform Network Code (UNC) that builds on existing industry frameworks and would not require industry participants to undertake significant changes.

Option 2, in which the IDN establishes governance arrangements, introduces a risk of substantial change resulting in further industry fragmentation. It would be in line with current regulatory regime for IGTs, where the goal of harmonisation with Transco's Network Code has still not been achieved.

Option 3, new governance arrangements in gas (extending the SPAA proposal to incorporate agent arrangements), is not supported by BP, and Ofgem are well aware of the concerns of I&C suppliers in relation to SPAA.

## **LICENSING ARRANGEMENTS**

Option 1, to establish a transmission licence for NGT's NTS business and distribution licences for each DN including those that have been retained under NGT's ownership, clearly distinguishes and identifies roles and obligations of transmission and distribution licence holders and makes regulatory accountability clearer. It also allows for the separate development of transmission and distribution licences. Legislative changes will be required and this option would take longer to work out, but it minimises potential for discrimination by Transco and may be the only way of avoiding conflict should Transco wish to retain a number of DNs.

Option 2, to continue with the present GT licence, segmented into NTS and DN activities, is unlikely to require legislative change. Separate transmission and distribution obligations would be created, though it would still be a "GT" licence and each DN that has been sold would be a separate licensed entity. This option is simple and would require minimal change.

BP can see advantages in both options (accountability v. simplicity) and would like to see further work carried out to assess whether Option 2 could be worked up to provide sufficient assurances on accountability and non-discrimination. In the absence of these assurances BP's initial preference would have to be for Option 1.

All changes to regulatory architecture in terms of licence arrangements must be completed **prior** to any consent being given to a disposal of DN assets.

## **NETWORK CODE ARRANGEMENTS**

Option 1, separate network codes, modification rules and framework agreements for NGT and each DN, has a high impact on shipper systems and costs, and would subject shippers to be a party to two or more separate commercial regimes for balancing and network access, including separate commercial arrangements with each DN and the NTS. It would be unnecessarily complex and BP does not support this.

Option 2, a Uniformed Network Code (UNC) which would apply to NGT and each DN specifying the transmission and distribution arrangements for NGT, shippers, independent DNs (sold by NGT) and retained DNs, is more efficient and less costly and minimises disruption for shippers. It also minimises potential for different DNs to develop their own separate transportation arrangements and code modification rules. Consistent transportation arrangements would reduce barriers to entry for shippers and market distortions across different zones. This would be BP's preferred option. BP would also prefer to retain the existing gas modification process and does not see the need to replicate electricity type arrangements.

Option 3, to have a common distribution network for all DNs with a separate code for NGT, is more complex and costly both administratively and commercially. BP notes Ofgem's thoughts that the industry may need to start with Option 2 and evolve in future to Option 3, but BP would recommend that industry should be re-consulted at the appropriate time to consider whether this would be necessary, and a review and RIA carried out before committing to this.

BP notes NGT's proposal to establish an Agency to manage (on behalf of all GTs operating under the UNC) a large range of functions relating to the network and shipper interface (including supply point data and shipper invoicing). It is unclear whether this agency would sit inside or outside NGT/Transco. Clearly it is simpler for shippers to just deal with one agency, but this is another area where more detail needs to be worked out.

All changes to regulatory architecture in terms of network code arrangements must be completed **prior** to any consent being given to a disposal of DN assets.

### **OFFTAKE AGREEMENTS**

Whilst it is not stated in the document, we assume that in order to avoid discrimination, Offtake Agreements would be proposed both for DNs that were sold, and those that are retained by NGT.

We believe that it would be useful to the debate to develop a better understanding of how Offtake Agreements might evolve over time, and what processes they would be subject to in order to regulate future change.

Overall having studied the consultation document BP remains to be convinced that significant complexity will be avoided. We believe issues may exist in relation to achieving measurement of all entry/exit points in Network, both between the NTS and DNs and between DNs themselves.

### **EXIT CAPACITY**

Exit reform is included in the consultation document, and is indicated as an essential condition of granting DN separation/sale approval.

It is however BP's view that whilst there may be need for reform of the Exit regime, it should be progressed separately from the consideration of DN separation/sale, so that the costs and benefits of each area can be established. We do however acknowledge that whilst undertaking such separate consideration, co-ordination of the two areas would be necessary to ensure that any change proposed in one area would be compatible with the other.

### **ENERGY BALANCING**

Tensions currently exist in the energy-balancing regime between NGT's commercial incentives and the physical balancing needs of the system. We suggest that these tensions would be further exacerbated by fragmentation of DNs and any separation of system operation. It is therefore our view that should separation proceed, a single system operator would be essential.

The consultation document appears to indicate that if as a result of DN separation/sale regime performance deteriorated, then Ofgem would look to undertake corrective action. It is however BP's view that consideration of DN separation/sale should include criteria within the gateway concept designed to ensure that no deterioration in regime performance occurs. This we suggest is preferable to the different stance of inferring deterioration might be an acceptable result as long as corrective action takes place.

## **SUPPLY POINT ADMINISTRATION (SPA) PROCESSES**

Currently the GT licence sets out obligations to provide an SPA service either by establishing one themselves or procuring this service. Shippers and suppliers have developed their systems and procedures to meet the requirements of NGT's network code which covers contractual issues relating to the provision of SPA.

Option 1 is to transfer the responsibility for the operation of systems and procedures to each independent DN who would develop and provide their own set of business processes to support change of supplier activities. BP does not support this option as we need to minimise system changes and costs on shippers and suppliers (and ultimately customers). Maintaining integrity of data and systems is a key concern. We fully agree with the need to avoid market fragmentation (7.7); suppliers should not have to engage with significantly different processes in order to transfer a customer served by different distribution networks. If shippers and/or suppliers are required to invest in multiple systems then this is grossly inefficient, and if investment cost is high then suppliers may only choose to compete in different areas of the country which would have negative consequences for customers.

Option 2 is to contract the responsibility to a 3rd party. This Agent set up is preferred by NGT, however issues arise as to who owns the agent - solely NGT or jointly between NGT and an independent DN. The UNC would govern transportation arrangements and the Agent would undertake support/administration functions on behalf of IDNs and RDNs. Shippers would accede to a contractual arrangement with each IDN which would bind them to the UNC. BP would prefer data services to be provided centrally, but need to better understand the benefits of adding an Agent into the chain, and what additional costs this might involve, e.g in respect of the associated charging and governance arrangements. This would be a significant change, and would be further complicated if the Agent was jointly owned by NGT and DNs and would need watertight contractual agreements between all parties to ensure there were no gaps or confusion regarding their responsibilities at the interface.

There are also issues regarding how NGT's agent would be funded, either through Transco's price control (Option 1) or by NGT and IDNs (Option 2). The first option means it essentially stays as it is, so users of agent services would not know how much they are paying for agent services and there would be no clear incentives on Transco for delivering more flexible agent services. Option 2 would set clear price signals for agent services and products which could give IDNs and shipper/suppliers more control over SPA services provided. BP is not convinced of the benefits of an agent set-up so sees no benefit in entering into a debate at this stage regarding funding arrangements. Clearly, if the agent option is pursued, we would expect further discussion and analysis of costs and benefits to take place.

With Option 3, NGT (as the gas transmission operator) would continue to provide services on behalf of DNs. This would be BP's preferred option as it requires less change, but NGT may need to establish a more flexible model with incentives to promote innovations that support the retail market and the increasing amount of industry data being exchanged.

NGT also consider an "alternative approach" whereby the Elexon model could be adapted to establish the Transco agent services, and we note that "some gas shippers have expressed some reservations about the adoption of this electricity type model". BP is prepared to discuss this model but at this stage remains to be convinced of any benefits of introducing this model into the gas market.

Whichever option is favoured by the industry, there will be much more analysis required before a decision can be made. Ideally we would like to keep it simple and have data managed centrally, but if managing multi-parties has demonstrable competitive benefits, we should have in place one charging structure (albeit there may be a "menu" of services and different levels of charges) to ensure minimal disruption to systems and associated costs.

## **GAS QUALITY SERVICES**

The proposal suggests the consideration of introducing quality services/charges if a DN was sold, suggesting that incentives could be placed on NGT as NTS owner/operator to offer gas quality services to users on a non-discriminatory basis. DNs would have the option of either a quality delivered to them at their required specification, or the option of installing their own equipment to process to final specification.

We remain to be convinced that such arrangements would be practicable in reality, even if theoretically possible following consideration by Ofgem, HSE and the DTI. We would therefore welcome further details of the proposal in order that we can understand how it is envisaged they would work in practice.

### **IMPACT ON SAFETY/EMERGENCY ARRANGEMENTS**

The sale of a DN would require the safety case to be amended, and the HSE will therefore need to be consulted and satisfied. Ofgem have stated that NGT intends to retain the responsibility for providing the national emergency number service.

In the event of NGT retaining responsibility for the national gas emergency number and if the first response workforce associated with the DN is included in the potential sale (a possibility), we would have to have assurances on how the interface would work. This again is an area for further work and discussion.

BP fully agrees with paragraphs 8.17 to 8.19 on Safety Cases, i.e. there are issues that need to be considered; NGT will need to satisfy HSE there will be no reduction in the safe management of the gas system; and prior to completion of a sale the buyer will need to have a safety case for that DN which has been accepted by the HSE.

BP agrees that in the event of a major supply loss incident, we must ensure that arrangements between DNs and NGT are in place to reconnect all customers as soon as possible. Further detail and assurances are needed on how this would work.

### **TRANSMISSION AND DISTRIBUTION PRICE CONTROLS**

Generally, BP would not wish to see a divergence of charging methodologies between DNs. Whilst divergence may be seen to offer greater innovation, we believe that there are benefits in keeping a consistent set of methodologies to avoid increasing the complexity of charging arrangements and thereby minimise the need for systems change. Too much "innovation" may also hinder supply competition.

We note that Ofgem has now issued final proposals for the separation of LDZ price controls, which are due to be implemented in April 2004. These may need revisiting and therefore require the allocation of additional resource if one or more DN businesses are sold. Such associated cost and resource implications need to be fed into the RIA calculations.

One of BP's specific areas of concern is the control of mains replacement policy of the incoming owners of any Distribution Network. If DNs were classed as 'private' how would the replacement policy be enforced? We would expect the HSE to have a major influence on how the private companies operate in this area, but have concerns relating to those areas where private company financing decisions could drive the funding of mains replacement. We therefore seek assurance that Ofgem would ensure that the incoming private companies are controlled by legislation relating to the policy of mains replacement.

There are further issues that would also need to be addressed. These include; identification of mains and MPRNs, new connections, Internet Maps, private networks, maintenance and control of information, database location, and procedures and regulation for UIP/IGT connections. Concerns regarding these issues increase in the face of fragmentation arising from the potential separation/sale of DNs.



## **METERING**

NGT has indicated that the sale of metering assets will not be included in any DN sale. There would clearly be some implications in NGT retaining ownership of meter assets whilst still having obligations within their GT licence.

This is a concern to BP, and both Ofgem and Transco are aware of our views that unless Transco offers for sale its meter assets, there is and will remain no real competition in the meter provision market.