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Dear Sonia,

NGT – Potential sale of gas distribution network businesses
Final Impact Assessment

Thank you for the opportunity to respond to this document; BP's response is not confidential and may be placed in Ofgem's library and on its website.

Ofgem have requested respondents to state whether they support a 'sale' or 'no sale option. The issue of ownership of DN assets is not within BP's remit. However BP's concern is to ensure that, should the Authority, the Secretary of State and the HSE consent to DN sales, a robust and workable solution is implemented which is beneficial for customers and industry participants.

BP has a number of significant concerns in relation to the IA and the likely impact of DN sales that might result from the current proposals. Consequently BP cannot support the existing proposals for DN sale at the present time.

With the lack of detail in the IA, current workload, imposed timetable and finite resource, it is not practicable for BP to comment comprehensively. We are therefore left with no alternative but to comment on a high level basis and focus on specific issues. For the avoidance of doubt silence on any particular aspect of the proposals should not be construed as acceptance by BP.

Before addressing selected issues I would firstly like to make some general comments.

General comments

(i) Magnitude of potential benefits

Ofgem estimates that the present value (2004 based) of net potential benefit to customers will range between £80m and £500m with a base case of £225m (or approximately 60p per customer per annum). It is interesting to note how wide this range is.

Ofgem's analysis has been undertaken against an 18 year timeframe. BP remains to be convinced that such a long timeframe is the most appropriate reference. We believe that it would be more realistic to assess against a shorter timeframe, such as the 5 year period used for Price Control purposes.

In the present IA 95% of the base case benefits of £225 million in present value terms are estimated to be derived from the introduction of comparative regulation. A very significant proportion (if not all) of these savings would have accrued through the introduction of separate price controls, without any sale. BP therefore believes that this proportion should be excluded from the benefits of the present 'sale option' as they could be expected to be applicable under either scenario. Only the additional marginal savings from a change of ownership should be used in determining the benefits under the 'sale case'.

(ii) Regulatory burden

Whilst BP recognises that some projects, such as the potential sale of NGT's gas distribution network businesses, are not initiated by Ofgem, BP remains concerned by the high level of regulatory workload. For example, over 2,200 pages of Impact Assessment and Licensing consultation along with appendices and annexes have been published on DN Sales over the last few weeks alone. At the same time industry workgroups continue, resulting in a plethora of documentation requiring review and analysis.

Like other shippers and suppliers, BP's regulatory resources are finite, being driven by the need to remain competitive.

We are concerned that important issues may well lie undetected within the vast amount of relevant data, as a result of high regulatory workload. Such issues may only come to light much later. We are seriously concerned that the current level of regulatory burden imposed by Ofgem will have significantly increased the probability of errors and omissions and consequent remedial costs for the industry which may in due course be borne by customers.

(iii) Process concerns

BP has concerns regarding the process of development work associated with DN sale. This IA has been issued as a "final impact assessment", but in our view significant amounts of detail relating to the proposals still remain to be developed. For example the Exit Reform Workgroup continues to develop detail which cannot therefore be taken into consideration with this final IA. It is therefore not possible to provide a comprehensive view on as-yet unfinished proposals for fundamental change.

The project plan to deliver DN sales lacks detail, and appears to be driven by arbitrary deadlines, rather than the need to ensure robust solutions.

BP believes that there are a number of non-essential proposals for Exit and Offtake 'tagged on' to the DN sale work. We believe that their inclusion would introduce unnecessary levels of complexity and BP remains of the view that such issues should be considered separately.

I now turn to the specific areas on which Ofgem has requested views, and take this opportunity to also refer you to points expressed by BP in responses to earlier related consultations and to the four IAs issued earlier this year, all of which have fed into this final IA.

Specific Comments

Potential costs

Industry fragmentation and the impact on shipper interfaces - increased fragmentation will inevitably lead to increased shipper costs which, as acknowledged by Ofgem, will be passed through to customers.

Industry fragmentation and the impact on decision making – inevitably incentives upon GTs to operate the GB network as a whole in an optimal and co-ordinated manner will be more limited than they are currently, and this is a concern with regard to the economic and efficient operation of the national network.

Competition - it is our view that excessive regulatory burden constitutes a potential barrier to new market entrants, as well as potentially jeopardising the quality of regulatory solutions currently being produced by the industry. The additional complexity and administration associated with DN sale could, we believe, if considered in isolation, be detrimental to competition. We question whether the overall impact of DN sales is beneficial to competition.

Security of supply - we believe that the separation of DNs provides significant challenges that must be comprehensively addressed if security of supply on both a long term and short term basis is to be maintained at current levels.

Options

No sale option
Under the "no sale" option there would still be a level of benefits attributable to comparative regulation, and these benefits should not be included under the "sale" option.

Sale Option

- Flow Flexibility Product

BP has serious concerns regarding the proposed flow flexibility product. This particular proposal appears to have been introduced at a very late stage and detail is severely lacking; Ofgem in fact acknowledge that this IA "outlines" proposed arrangements. Whilst we understand that clarification and further detail have been requested at the Exit Reform Workgroup, we believe that it has still to be provided. It is therefore our view that the proposed flow flexibility product is not yet sufficiently defined or understood by the industry and that many questions remain to be answered. We are not convinced of the merits of, or indeed the need for, this product. It would not be in the interests of customers or the industry to hastily introduce a flow flexibility product.

- Exit capacity

As mentioned above, BP does not believe fundamental exit reform is a pre-requisite for DN sale to proceed, and believes that it should be considered separately. The proposed auction based exit capacity regime includes the offering of exit capacity as a long term product. We continue to believe that this will create issues for customers, the majority of whom generally have supply contracts of less than two years duration, and who may switch suppliers frequently. Shippers would naturally have to take into account customer behaviour when booking capacity. It would be of assistance if Ofgem could provide information to help the industry gain assurance that the proposals to book exit three years ahead will work effectively.

Agency and governance
The creation of an agency to manage the interface between the DNs, NGT and shippers/suppliers will mitigate some of the fragmentation that DN sales will create. The decision not to include the transportation cash collection within the agency model that has been adopted will lead to shippers having to potentially liaise with nine separate contacts if queries arise from their invoices. This could increase costs for shippers as they will have to amend their systems accordingly. At present a shipper may withhold payment of transportation charges as long as they have logged a query before the due date on Conquest. It is unclear whether a shipper will still be able to use this method or will be required to log queries with the individual networks. Shippers will also be required to set in place individual credit arrangements, which again will lead to increased costs for the shipper. We also have concerns over the current timeline which already appears to be

failing. For instance, agreed UNC Business Rules are expected to be published on 21 December, and although a version of the Rules is expected to be delivered on time, it will not be either complete or agreed and there are still areas regarding Category 2 & 3 changes that have not been discussed. These issues are therefore being "carried over" as there is no other alternative.

Potential competitive, environmental and social impact

Impact on competition
BP agrees with Ofgem's view that inefficient fragmentation could discourage market entry and weaken wholesale competition. The proposed agency arrangements are intended to prevent these negative impacts on wholesale competition by preserving a single uniform interface between network operators and shippers. Since Ofgem have now stated that the DNs will not be allowed to opt out of agency arrangements (as was previously intended to be the case), there is a better chance that these arrangements could work.

Impact on the environment
We would expect current management and regulation of environmental impacts, and licensing incentives to minimise losses, to continue.

Impact on income distribution
We understand that DN sales may have a detrimental impact on the extension of the national network by IGTs, and may therefore act as a disadvantage, rather than a benefit, to the fuel poor.

Analysis of benefits

There is an assumption that benefits may be achieved through potential improvements to DN efficiency following the sale, but the opposite may be true, and any additional costs would be passed on to customers. This needs to be clearly recognised by customers.

Risks and unintended consequences

BP believes that there is a significant risk that benefits of DN sales may have been overstated; in particular with regard to the benefits of comparative regulation (which accounts for 95% of the total benefits), much of which would be achieved under the "no sale" option.

BP believes that there is a significant risk that costs have been underestimated. BP is disappointed with Ofgem's view that shippers might have overestimated their costs. If anything, we believe the opposite is more likely to be true, particularly since more information is now available regarding potential changes than was the case at the time of Ofgem's request for estimates of shipper costs.

Analysis of costs

We note that Ofgem quote that shipper costs "could be scaled down" (9.51). It would be useful to understand in greater detail why Ofgem believe this to be the case. We would argue that as a fully detailed analysis has not been possible, that in fact there is a much greater potential for these costs to have been under estimated rather than over estimated. Given the information available at that time, BP is convinced that we have not overestimated its costs in the proforma provided to Ofgem.

For example, BP's estimate did not include any metering costs since insufficient information was available at that time to make a calculation. Our position now with regard to metering costs is as follows;

Metering
- The IA does not consider metering costs incurred either at "hive-down" or those arising after 12 months from DN sale when NGT "support" to the metering arrangements for the DNOs is withdrawn.

- The timeline of 4/5 months to make both contractual and system changes required to support the continuation of metering services post "hive-down" is overly optimistic and challenging.
- NGT have only recently sought to engage the industry and potential systems implications were only made known at an industry meeting on 14 December; at this same meeting industry noted the urgent need to reform the MDIG and to set up a contractual negotiation workgroup.
- The decision by NGT to simultaneously restructure its metering business also has a potential impact. NGT's metering business encompasses the vast majority of metering assets in the UK. This raises concerns over the development of an unregulated monopoly exercising considerable influence in the operation of the UK metering market. We strongly urge Ofgem to consult formally on the proposed restructure.
- A list of issues impacting metering as a result of DN sales is included within this response as an appendix to illustrate how issues become apparent as one starts to consider the detail.

We also comment below on other cost areas relating to the shipper cost pro-forma;

<u>System changes</u>
Ofgem state that they have scaled down shipper cost. It should be noted that shippers operate different systems and that these will require differing levels of change to accommodate DN sales. Depending on the resources that a shipper has at their disposal they may have to contract out their IT work. This additional cost of hiring IT consultants can be comparatively high compared to using in-house resources. The amount of time that a shipper has to spend on planning system changes and designing new processes and interfaces can be both time consuming and costly. It should also be noted that if a shipper has a relatively small portfolio of supply points then the impact on costs passed on to the customer will be greater than for a shipper with a far greater number of supply points.

<u>Staff costs</u>
Different shippers will have used different rates depending on their individual circumstances, including commercial market rates and whether resources can be provided internally or have to be purchased on a consultancy-type basis.

<u>Credit arrangements</u>
BP disagrees that credit management is not a material cost. These agreements take time and resources to put in place and shippers will need to pay commercial rates to set up credit agreements with a larger number of parties. Companies with limited resources may require the services of external parties, again incurring additional costs.

Conclusion

For the reasons stated above BP does not support the proposals contained within the IA in their current form. BP remains to be convinced that the timetables currently adopted will not compromise the quality of the solution achieved.

We are concerned that costs may be significantly higher than the estimates produced, and suggest that these be refined in the light of the full detail once it becomes available, to give a more realistic assessment of likely potential costs. We believe it is important that customers are made fully aware of this risk and that any increase in costs or reduction in benefits will be passed on to them.

We hope that you find our comments helpful; we have also included a short summary of our response, as requested. This is attached as appendix 1. Please do not hesitate to contact me if you would like to discuss our response.

Yours sincerely,

Beverly Ord
Regulatory Affairs

Appendix 1

Summary of BP's response

BP has significant concerns about the IA and its likely impact. We do not support the existing proposals. Our concern is that, should consent be given to DN sales, a robust and beneficial implementation is achieved.

These proposals lack significant amounts of detail. With this lack of detail and high regulatory workload arising from optimistic timetables, it is not practicable to comment comprehensively. BP's comments are therefore high level.

BP believes that the Exit and Offtake elements of the proposals should be considered separately and are not a pre-requisite for DN sale.

BP has serious concerns about the flexibility product. It is insufficiently developed or understood. We cannot support the product as currently presented.

Ofgem estimates potential benefits over 18 years to be between £80m and £500m (an extremely wide range) with a base case of £225m (or c60p /customer p.a.). It would be more realistic to consider a much shorter time-frame of say one price control period.

95% of base case benefits are from introducing comparative regulation. A proportion of these benefits would have accrued through introducing separate price controls, without any sale. This proportion should be excluded from the benefits of the 'sale option'.

Ofgem believe shipper costs "could be scaled down". As fully detailed proposals are not available to assess, we conversely argue there is greater probability of under-estimation. Furthermore we are concerned that the imposed regulatory burden significantly increases the probability of errors and omissions and may result in remedial costs for the industry and customers.

BP is unconvinced by the proposals to book exit capacity three years ahead.

It is important that customers recognise that should Ofgem's cost estimates prove inaccurate, variances will be passed on to customers. There is no guarantee that potential benefits for customers will materialise.

Appendix 2

Metering Issues

Issues affecting the period up to Hive Down and first 12 months

- Development of separate DN specific databases managed by Transco
- Due to be completed and tested March 2005
- Confirmation of Validation between SAP Rainbow and DN specific databases
- Ability to access information (RFI facilities)
- Communication Protocol
- Use of IX as principal method of communication
- Testing
- Provision of a test environment (new system generating files)
- Rejection management (management of 4 separate databases)
- New Market Participant Code for IDNs
- NGT will need to raise a Change Request (CR) to the RGMA baseline through SPAACo
- New Contract Reference Numbers
- Suppliers need to assess impact on their systems (CR Internal)
- New Contracts both IDN and Retained DNO (not simply lift and shift of existing terms)
- Form a Contract Review Group (CRG) (NGT and DNs)
- MSA (RDN) (Revision required as subcontracting under new relationship)
- PEMs (RDN, IDNs) New contracts required for RDN and 4 IDNs
- P&Ms (RDN,IDNs) New contracts required for RDN and 4 IDNs
- Adversarial (RDN, IDN) New contracts required for RDN and 4 IDNs
- Works (Services for 12 months - I&C) (RDN, IDN) New contracts required for RDN and 4 IDNs
- SUA (revision required)
- In terms of work this would require legal review of some 20 + agreements (although a number will be substantially the same in content)
- New Credit Arrangements for contracts
- Processes and File Formats
- Reformation of the MDIG
- New invoice formats
- Impact of New Market Participants
- Impact on CoS
- Impact of Dual ONJOB generation
- MDIG to formally check if any other impacts.
- Site Works
- Clarity required on the arrangements for Site Works services at Hive Down and whether separate contract for each DNO are required.
- SPA Impact
- Any file format changes need to be checked against existing SPA processes to ensure end to end process integrity
- Re-labelling Meters
- All meters fitted by Transco assumed to be Transco assets and labelled accordingly.

Issues affecting the period after withdrawal of NGT support to DNO's

- New Contracts
- New Systems (DNs)
- Parallel development required during 12 months from Sale
- New RGMA complaint systems need to be developed by DNOs
- New Query management systems required
- SPA
- Use of IX
- Transco influence as large operator of assets outside its retained Networks
- DN being ready for withdrawal of NGT support.

These costs are likely to be significant and since we know that they will be incurred they should be factored into the DN Sales Impact Assessment.