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email: kyran.hanks@ofgem.gov.uk

via email only

25th September 2003

Dear Kyran,

Re: National Grid Transco – Potential sale of network distribution businesses

Thank you for inviting ConocoPhillips (U.K.) Ltd (ConocoPhillips) to make representation of their views to the above consultation document. Our detailed comments are below.

Regulatory Impact Assessment (RIA)

ConocoPhillips are pleased that Ofgem are adopting this approach of assessing the impact a major change could have on the industry and using it to aid their decision making process. The analytical presentation offered in the discussion of the preliminary Regulatory Impact Assessment, however, is lacking in supporting data and baseline assumptions. More information is required to understand the values attached to the costs and benefits stated, and to enable us to determine whether the assessment is an accurate representation.

A thorough and accurate assessment is required to ensure the industry is fully aware of the effect the wide range of options would have on the outcome. All scenarios that are investigated need to be presented with the relevant assumptions clearly indicated.

Ofgem must ensure that the “status quo” option incorporates the effect of any ongoing projects such as, reform to the Exit and SPA regimes, which are expected to continue, irrespective of sanction being granted for the sale of a distribution network.

Ofgem has commented that savings of 1.3%/annum could be achievable over the next three price control periods resulting in an NPV of up to £300m. We would expect Ofgem to target the delivery of these savings through successive DN price controls. As such the RIA should be showing the benefit accruing to industry through the change of ownership of a DN rather than savings that can be achieved generally. In terms of the benefit shown the numbers may not justify change either. A saving of £150m as quoted by Ofgem is roughly £15m per DN. If only one DN is sold the costs outweigh this benefit, which we see as being achievable through DN price control.

Timing

The timescales in which Ofgem expects to conduct this project and to incorporate all the required changes are impressive. We are concerned that less than comprehensive discussions may ensue in order to achieve all the relevant changes, to obtain consent for disposal in the suggested timeframe. The benefits of pushing the industry to apply resource to discuss and debate the issues of this extensive project, in such a tight timeframe, must be weighed up against the cost of neglecting other industry issues.

The “gateway” concept is a novel approach for Ofgem and we agree that such a process may be necessary for the success of this project. Nevertheless, we have concerns as to what extent Ofgem would accept that an “agreement” has been reached on the specified issues and what the consequences may be for Transco if they were not fulfilled in the agreed time. Non-compliance of the agreements could lead to future regulatory complications if not managed properly.

Regulatory architecture

We do not believe that discussions regarding the regulatory architecture need to be held concurrently; in fact it may be better if it was considered after the fundamental principles are agreed upon and then ensure that the regulatory architecture supports the intent of these principles. There is a request to maintain a format that is not complicated but transparent with a degree of commonality between the Independent DNs and Retained DNs.

The power sector provides experience of what could happen if DNs are sold off. Separate Distribution Network Operators (DNOs) with a number of codes can and does lead to numerous meetings where only particular aspects of an issue is discussed rather than the whole. We should strive to minimise the number of codes, avoiding inconsistency and providing for consideration of all consequences of modifications proposals, as is now the case in gas.

Other related issues

During the Ofgem seminar the industry was asked for their appetite for change and to what extent we, the industry, are open to reform. Putting aside the merits for change, this is a question of level of industry disruption, in terms of allowing sufficient time to understand the new regime and raise awareness internally. Also time is required to manage the necessary system changes in a short time span.

Should the sale of DNs proceed we would endorse making only essential changes with the prospect of enhancement of the regime to be developed in time, where relevant discussions have been conducted to establish necessity and requirements.

The exit and SPA regimes are ongoing projects and should continue with the potential sale of DNs in mind. Separate gas balancing regions and introduction of a linepack service between the NTS and DNs, are issues that require industry debate and the benefits of both to be established.

In our view gas balancing should be managed by a single system operator. To introduce multiple system operators, with shippers being required to balance each distribution network and the NTS separately, would introduce unnecessary complexity and costs to all participants and hence consumers.

The separate ownership of DNs and the NTS, in our view would increase operating costs through duplication of roles for both the new DN owner and NGT. For a shipper there will be greater complexity in delivering gas to the end user and potentially a barrier to new entrants.

With more players involved in the transportation of gas to customers, there will be a further increase in costs. A greater risk of supply failure is also more likely with the new contractual links in the gas chain.

The arguments presented in support of the potential sale of a distribution network fail to convince ConocoPhillips that the expected savings for customers outweigh the costs to industry. The sale of a DN appears to benefit only NGT shareholder value, with greater potential for raised charges and complexity to shippers and suppliers.

Therefore, until further analysis is presented to convince industry that there are significant real net benefits, ConocoPhillips do not support the sale of a Distribution Network.

If you would like to discuss any details further please contact me on the number below or alternatively speak with Barry King on 020 7408 6303.

Yours sincerely,

J. Maisuria

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cc. Mark Feather, Ofgem.