



Gas & Power Europe
Portman House,
2 Portman Street,
London, W1H 6DU
phone +44 20 7408 6303
fax +44 20 7408 6839
www.conocophillips.com

Andy MacFaul
Head of Government Affairs
Ofgem
9 Millbank
London
SW1P 3GE

2 March 2005

Dear Andy,

Ofgem proposed Corporate Strategy and Plan (2005-2010)

ConocoPhillips (COP) welcome the opportunity to comment upon Ofgem's proposed Corporate Strategy and Plan to cover the next five years to 2010.

We believe it is appropriate for Ofgem to seek industry views on whether it has correctly identified the most important issues, and whether the correct level of resource has been allocated to deliver the required result in an appropriate timeframe. While Ofgem should be applauded for self-imposition of an RPI-X constraint on its controllable costs, it remains the most expensive economic regulator in Europe. We also believe that the best way for Ofgem to meet its regulatory remit of protecting customers is to be rigorous in the regulation of monopoly activities, whilst allowing competitive activities to develop appropriately. This dual approach will help to ensure both the efficient delivery of gas and electricity to the market, and assist in the safe and secure supply of energy in future. But, how this approach is applied could have a direct approach on incentives in the sector, and it is essential that Ofgem continue to refine its implementation of impact assessment.

COP has the following detailed comments regarding Ofgem's proposed Corporate Strategy and Plan, 2005–2010:

- **Gas Quality.** COP believes it is appropriate and necessary for Ofgem to continue to work closely with other Government agencies, i.e. HSE, DTI and DEFRA, industry and customer groups to tackle the issues arising from changes to gas quality specifications, as the UK confirms itself as a net importer of gas. We would expect the achievement of greater progress regarding potential UK solutions, given that there is now an agreed consensus on specific parameters regarding EASEE-gas. We would like to stress the importance of addressing, in particular, the issue of lower wobble gas, as the number of off-specification

discoveries in the North Sea increases. Security of supply in the short term could be improved if fields do not have to lock in gas as a consequence of blending constraints. However, if new discoveries of lower limit wobble gas could be delivered on to the National Transmission System, the UK could delay or reduce its dependence upon gas imports for a longer period into the future. COP would like to request the publication of the two remaining documents of the three-part study of UK gas quality specifications commissioned by Ofgem, DTI, DEFRA and HSE. We believe that these documents may help to facilitate potential UK solutions being considered by the Stranded Reserve Workgroup. It is obviously necessary for the industry to participate in discussions to establish the final solution to resolve UK gas quality specification issues.

- **Regulating network monopolies.** Ofgem has suggested (paragraph 2.13) that one way being considered to provide both effective regulation in the electricity and gas markets, and improved market signals for new investment in these networks, would be through users purchasing forward rights to use the networks. COP believes it is inappropriate to impose capacity auctions within the electricity market, due to the commodity being instantaneously delivered and used, and also because of the need to retain a strong element of central planning. It is difficult to imagine an auction mechanism within the electricity market that would be capable of materially improving the necessary investment signals compared to the process that exists at present. Within the gas market at existing locations, we do not believe that the auctioning of entry capacity has provided any meaningful investment signals as yet, but has imposed significant new cost. A full assessment of the success and failure of introducing capacity auctions in the gas market – as well as the costs and benefits of change proposals for electricity – should be undertaken prior to designing and implementing such a regime within the electricity market. Further, there are much more pressing matters that require attention, especially with regard to transmission charging and the pressing need to develop a firm access regime and long-term charging regime that draws on current charging structures.
- **Importance of Europe.** COP supports the priority given by Ofgem to working with the Commission and national regulators to promote full and effective liberalisation of the European energy markets. Ofgem should continue to encourage the Commission to adopt market-based solutions rather than proposals advocating centrally controlled regulatory solutions. We would also urge Ofgem to encourage the Commission to ensure that existing directives, some of which are very new and untested, are enforced before further regulation is contemplated. Besides encouraging the liberalisation of European markets, the UK must also ensure it is implementing proposals that are consistent with the direction in which European Commission policy objectives are heading. A prime example within the UK electricity market is that of transmission network use of system costs, which are

split 27:73 between generator and suppliers respectively, even as European policy moves towards recovering transmission costs not from generation but from suppliers.

- **Cost-reflective charging.** The principle of adopting cost-reflective network charges is an important element in ensuring that one technology is not unduly favoured over another and that dynamic efficiency in new investment is encouraged. Wider environmental and policy considerations are matters for the government, and should not be incorporated into network charging methodologies, as we have recently witnessed in the UK with both the hydro benefit and the 132kV connected generation. Any material dilution of the cost reflectivity of current charging arrangements based on ICRP will send out the wrong locational signals for transmission investment. Any non-transmission issues should be dealt with outside the charging arrangements by way of subsidies that are both explicit and transparent to the market.
- **Environmental Improvements.** Ofgem should aim to reduce the costs to industry participants wherever possible so as to reduce the administrative burden and barriers to entry. This should be a particular area of concern in the field of renewables and CHP.

Please call me on 020 7408 6233 if you would like any further comment.

Yours sincerely,



Rekha Patel