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Sonia Brown
Director, Transportation
Ofgem
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Dear Sonia

Initial proposals on interim incentive schemes supporting the offtake arrangements

I provide below the principal issues that our consortium wishes to raise on this initial consultation. As a general view, we support the establishment of simple, transparent incentives, particularly given the short timescales associated with the issue of final proposals and implementation in a matter of weeks.

Scope, form and duration of the incentive scheme

We welcome the establishment of a single incentive scheme for DNs in the interim period to October 2008. Splitting the proposed component parts into more than one scheme would be unnecessarily complicated.

The principle of taking account of the 'value' of incremental requests for flat and flex offtake rights provides a relatively simple measurement which DNs can quantify when assessing the need to make requests for the release of incremental capacity rights.

We note that the proposed payment flows will remain consistent within the interim regime as they currently stand. The incentive payments to (from) the DN will be made through adjustments to DN exit capacity charges. To that end, will adjustments be made annually, and be levied over a twelve month period? It would be helpful to more fully understand how a defined incentive period is to be subsequently reflected in adjusted DN exit capacity charges.

The planned duration of the interim incentive scheme should naturally extend across the whole interim period (1 May 2005 - 30 September 2008). Consistent with our view of a review of the enduring arrangements later in 2006, we similarly support a

review of these arrangements linked to planned reform of interruption arrangements in April 2006.

Interruption

The change within the rules relating to directly connected NTS direct customers having the right to have their additional NTS exit capacity requests met appears to jeopardise DN certainty of supply to its DN interruptible sites.

We welcome Transco's statement that this would not require a corresponding increase in the interruption of customers connected to the DNs, however we would be interested to know at what level any such increase may impact on DN customers.

Our concerns are centred around two linked issues:

1. Certainty of supply for DN interruptible customers. The absence of any degradation of supply availability must be assured.
2. The DN incentive framework factors in the cost of greater than 15 day interruption of DN connectees. If the assured NTS direct customer capacity requests negatively impacted on DNs frequency (and cost) of interruptions, we would expect a revision to the incentive framework to protect the DNs from such an event over which it had no control.

We anticipate Ofgem will closely monitor Transco's ongoing ability to provide this service to its direct customers at no expense to DN interruptible customers.

Caps, collars and sharing factors

The two proposed parameters for the DN incentive schemes relating to this area appear reasonable.

We have no strong opinion between the suitability of option 1 or option 2, however given that option 1 is consistent with the concept of a 100% sharing factor in the 'Enduring incentive regime', there may be more merit in applying option 1 for the period of the interim regime.

Reference price for offtake (flexibility) capacity.

We believe that NTS offtake (flexibility) reference price should mirror that of the flat capacity price. This provides certainty and simplicity, which are required cornerstones of this interim incentive scheme. The other two options, do not, in our view, provide sufficient certainty or confidence given the timescales associated with implementing these proposals. Deriving the reference price from the additional cost of a new piece of pipeline or by linking the price to the cost of providing gas storage in the DN network are not viable options. Either option or variant to it would require a full understanding and acceptance as to how such costs were arrived at.

If you wish to discuss any of the points contained in our response please do not hesitate to give me a call.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Alex Wiseman', with a long, sweeping horizontal stroke at the end.

Alex Wiseman
Gas Regulation Director