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Dear Sonia

Initial proposals on interim incentive schemes supporting the offtake arrangements

Thank you for providing us with the opportunity to comment on Ofgem's initial thoughts on interim incentive schemes to support the offtake arrangements following the DN sales.

EDF Energy generally agrees with Ofgem's proposals to retain the form and scope of the existing NTS Exit incentives in the interim period to the extent that they remain appropriate in the context of the interim offtake arrangements. We believe that there should be minimal change to NTS offtake arrangments as a result of the DN Sales, both in the interim and enduring periods, and therefore the current structure of incentives should be largely retained. This will reduce the risk of extra costs creeping into Transportation charges in the next few years.

We are also encouraged by Ofgem's view that the exit regime can effectively run as normal now for the next 3 years, without any major changes or repercussions in a divested industry under the DN Sales. We therefore, question the need for the fundamental reform that Ofgem is proposing for the enduring regime. Ofgem's concerns with the level of discrimination that may exist between NTS shippers and NTS DN offtakes seem to be allayed by the "statutory and licence obligations[1]" imposed on the industry to ensure that the new exit regime will be working properly in the interim period between September 2005 and April 2008. However, Ofgem's arguments for minimum change in the interim period run counter to the reasons given for pursuing

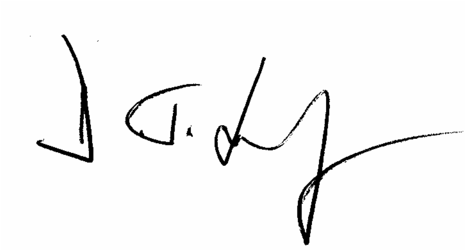
[1] Section 9(2)(b) of the Act – each GT has a duty to avoid any undue preference or undue discrimination in the terms on which it undertakes to convey gas

radical Exit reform in the long run and it would be useful to understand why these statutory and licence obligations are not sufficient to ensure that no discrimination exits between GTs and market participants in the allocation of NTS Exit capacity rights in the enduring arrangements.

We also note that Ofgem does not make reference to the revised price control due in 2008 and question how these proposals will fit in with both the new price controls and enduring exit regime incentives as it appears that these incentives will overlap by at least 6 months from April 2008 to October 2008.

We have provided more detail on the specific NTS and DN Exit capacity incentives in the attachment to this letter. If you would like to discuss any of our comments further please contact John Costa on 020 7752 2522, or myself.

Yours sincerely



Denis Linford
Director of Regulation

Attachment

EDF Energy's detailed comments on proposed NTS interim incentives

EDF Energy welcomes the fact that the 15 day interruption incentive will be maintained, with Transco being incentivised to buy-back capacity each day after 15 days interruption. We agree with Ofgem that this incentive should be set to zero for each of the interim years, since Transco has indicated that it will have spare capacity to accommodate requests from all NTS direct connects for firm exit capacity and thus should not need to enter into buyback contracts in the interim period. However, this fact does not sit well with Transco's view that buy-back costs in the order of £16m may be incurred if only a "limited number of (currently interruptible) sites were to request firm capacity", as stated in paragraph 4.19. We believe there is only a small likelihood of buy-backs in the interim period, judging by the recent low level of interruption in recent years and that customers will be no more likely to change from interruptible to firm contracts going forward, especially under normal winter conditions. We therefore suggest that option 2 is the most suitable buy-back and interruption incentive parameter to ensure Transco is duly incentivised to minimise the level of NTS curtailment in the next few years.

Also, it is not clear why the interruption incentive target for year 2008/09 is roughly the same amount as that set for previous years when the period of the incentive is for only 6 months from April 2008 to October 2008. We would expect the target for 2008/09 to be roughly half the £1.73m allocated to 2007/08.

We agree with Ofgem's sliding scale targets for Constrained LNG (CLNG) as the UK will have more flexible sources of firm supplies in the form of new interconnection and import facilities in the interim period which should minimise the use of storage facilities on a normal winter day. However, on a peak 1 in 20 day we would expect all storage facilities to be delivering gas onto the NTS at maximum rates in response to the high market prices that are expected to occur on such a day. EDF energy believes that the market will react in these extreme conditions and that a storage contract with Transco to deliver on that day is unnecessary. Therefore, we agree with the lower bound estimates for the last 2 years of the incentive and agree with the 100% sharing factors Ofgem has proposed.

With respect to the charges foregone and exit investment incentive we believe that option 2 should be adopted, to take into account the latest views of interruptible loads going forward. This would update the incentive and make it more robust.

DN interim incentives

EDF Energy largely agrees with Ofgem's proposals for the scope and form of the DN interim incentive scheme. However, we do not agree with Ofgem's choice of the reference price component used in calculating the cost performance targets. Ofgem has recommended that NTS exit charges are used to set the price for both flat and flexibility capacity charges in the calculation of the DN performance targets. This implies that one unit of capacity produces one unit of flexibility, which is inherently untrue, as the amount of flexibility available largely depends on the system configuration and thus, if used, would over-inflate the DN's cost targets. We would suggest a better surrogate would be to use a ratio of how much flexibility is produced from 1 extra km of pipeline capacity, the figures for which Transco should have. Once this percentage has been calculated, it should be used to multiply the exit capacity charges to produce a more accurate and cost reflective flexibility price and cost target. In this sense, our example would relate to option two in paragraph 4.57 but on a more sophisticated basis.

In relation to Ofgem's views on the use of DN demand side management tools as a trade-off between the cost of additional NTS exit capacity and increased interruption of DN Connectees, we question the scope for DNs and Transco to enter into these contracts in terms of time constraints, which becomes a greater problem if Ofgem intends that these demand-side contracts be extended to customers. The industry will be facing tight supply margins in the next few winters and it is our view that it may now be too late for DN connectees to enter into demand side contracts for this winter. Therefore, DNs will not be incentivised to do anything other than purchase the minimum amount of NTS exit capacity, as they can rely on their customers being interrupted. We would welcome Ofgem's views on how DNs can be appropriately incentivised not to interrupt customers unnecessarily but to seek to enter into demand side contracts, bearing in mind the potential impact this may have on the increasing gas price.

EDF Energy therefore believes that option 1 is the most appropriate level of incentive, to ensure that each DN is fully exposed to the benefits and losses associated with their decisions related to the trade-off between purchasing additional NTS exit capacity, interruption of DN connectees and contracting for demand management tools.

Finally, we believe that it would be useful if Transco and all GTs were to publish the amount of interruptible load on the NTS and DNs respectively each year once Transco and the DNs know how much firm and interruptible capacity has been booked. This would increase market transparency and enable participants to estimate the likelihood of demand side response during peak winter days. We believe this obligation should be introduced into the GT's new licence conditions or into the UNC prior to hive down on the 1st May 2005.

EDF Energy plc
April 2005