



Shippers, Transco, DN owners and
other interested parties

*By engagement – and value
to customers*

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24 June 2005

Dear Colleague,

Enduring offtake arrangements

At its meeting of 23 June 2005, the Gas and Electricity Markets Authority (the Authority) reviewed its previous decision to require the implementation of the National Transmission System (NTS) enduring offtake arrangements on or before 1 September 2005.

In reviewing its previous decision, the Authority has concluded that the enduring offtake arrangements remain an important aspect of the regulatory, commercial and operational framework necessary to protect customers' interests in a divested industry structure.

However, the Authority has decided that further time should be allowed for consultation on the development of the enduring offtake arrangements with a view to their implementation from September 2007 in the form of allocations of offtake rights from October 2010 onwards. In this letter, the Authority gives its reasons for this decision.

Authority decision on enduring offtake – January 2005

At its January 2005 meeting, the Authority endorsed the continued development of the enduring offtake arrangements and concluded that these arrangements are reasonable and necessary to protect the interests of customers. However, in response to concerns raised by industry participants the Authority concluded that the implementation of these arrangements did not need to occur prior to the completion of the gas distribution network (DN) sales transaction but should not be delayed beyond September 2005.

Review of enduring offtake timetable

The Authority's review of its January 2005 decision on the implementation of the enduring offtake arrangements was prompted by a number of factors including concerns raised by industry

participants that there is limited time available between now and the timing of the proposed long term allocations of NTS offtake rights in autumn of this year.

In reviewing this timetable, the Authority has been particularly conscious of the volume of work that remains to be completed by the industry in order to implement the enduring offtake arrangements by September 2005. In this respect, given the volume of work required on the detail of the allocation and incentive arrangements, the Authority agrees that industry participants may not have sufficient time to prepare for the long term allocations in autumn 2005.

In addition, the Authority has identified a number of interactions between the NTS offtake arrangements and the NTS entry capacity regime that need to be considered before the detail of the proposed offtake arrangements can be resolved. These interactions primarily occur in the setting of baseline capacity levels for release in the long term allocations of NTS offtake rights and in the setting of unit cost adjusters (UCAs) which are relevant to both the incentive arrangements and auction reserve prices.

The Authority considers that it would be beneficial to undertake this work in coordination with work being undertaken on the NTS entry capacity regime as part of the forthcoming Transco NTS price control review which is due to be completed by April 2007. This should ensure that all interactions between the entry and offtake regimes, including in relation to the setting of UCAs and offtake baseline capacities can be considered.

On this basis the Authority considers that the implementation of the enduring offtake arrangements should be delayed until September 2007 for the release of NTS offtake rights from 1 October 2010, consistent with Transco NTS three year investment lead times.

The Authority considers that a decision to delay is consistent with the principles of better regulation. Whilst it is noted that substantial consultation has already occurred on the framework of the enduring offtake arrangements, the Authority considers that its decision to delay implementation will enable further consultation against the detail of these arrangements which should assist in facilitating transparency and certainty for industry participants ahead of the proposed allocations.

Implications of a decision to delay

The present interim offtake arrangements and the allocations of offtake rights under these arrangements do not extend beyond 30 September 2008. Consideration will therefore need to be given to determining the mechanism by which capacity is allocated to DNs and shippers acting on behalf of NTS direct connects from the period 1 October 2008 to 30 September 2010. In addition, incentive arrangements for Transco NTS and the DNs will need to be developed for this period. The implementation of allocation and incentive arrangements is likely to require licence modifications, modifications to the Uniform Network Code and changes to Transco's NTS pricing methodology.

Given Transco NTS's investment lead times and the potential for incremental capacity requests to be made for October 2008, the Authority considers that it is important to work towards introducing suitable transitional arrangements later this year. In this respect, Ofgem will be

working with Transco NTS to develop a work programme and consultation timetable for the development and implementation of these arrangements.

Standard special condition A55

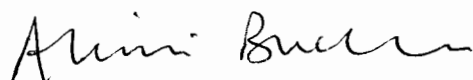
The Authority notes that under standard special condition A55, '*Enduring Offtake Arrangements*', each of Transco NTS and other relevant gas transporters (being Transco plc as the owner of the retained distribution businesses, Scotland Gas Networks Ltd, Southern Gas Networks Ltd, Wales and West Utilities Ltd, and Northern Gas Networks Ltd) are under a 'best endeavours' obligation to implement, on or before 1 September 2005, the enduring offtake arrangements in a form approved in writing by the Authority. In addition, as required by the condition, each has provided an ultimate controller undertaking to the Authority on this basis.

On the basis of the Authority's decision today, the Authority does not intend to enforce compliance with standard special condition A55 as currently drafted. The Authority will however give consideration as to whether this licence condition should be replaced or modified to introduce new requirements on Transco NTS and each of the DN businesses to implement the enduring offtake arrangements from September 2007.

Nothing in this letter is to be construed as granting any rights or imposing any obligations on the Authority. The Authority's discretion in this letter will not be fettered by any statement made in this letter.

If you have any questions regarding this letter please contact Mark Feather on 0207 901 7437.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Alistair Buchanan', written in a cursive style.

Alistair Buchanan
Chief Executive Officer