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Dear Bob

#### Proposed Incentive Arrangements for the Provision of NTS Entry Capacity at Milford Haven

We welcome the opportunity to respond to the above consultation paper and hope that you will find our views useful.

Although the consultation is seeking views on incentive arrangements that should apply to the NTS for the provision of entry capacity at Milford Haven, we believe it highlights a number of issues with the existing entry capacity regime. In particular, we believe that it illustrates the complexity that has been created in using the auction regime as a mechanism to facilitate what is essentially a new connection to the NTS.

As Ofgem has clearly identified, one such complexity is the impact that late delivery of a new connection (such as Milford Haven) has on the buyback incentive scheme. Under the current arrangements, late delivery by NTS of a new entry point is likely to involve all NTS shippers, and ultimately customers, by virtue of the buyback arrangements and incentive scheme whereas previously it would have been a bilateral issue between the relevant parties.

While we understand that Ofgem's aim is to mitigate this effect to a certain extent by strengthening the NTS incentive scheme so that, essentially, the impact of late delivery on other parties is reduced, it is yet another "fix" that is required to make the regime work. We continue to believe therefore, that there is an urgent need to fundamentally review the auction regime, particularly since Ofgem is keen to replicate the majority of the model as part of the NTS exit reform.

Notwithstanding the above, Ofgem has sought views on specific questions relating to the potential future incentive arrangements that would apply to Milford Haven. We have taken these in turn.

1. *Should new incentive arrangements for NGG NTS be developed in relation to the delivery of gas transmission capacity for Milford Haven?*

We believe that it is important to ensure that NGG NTS is appropriately incentivised in relation to the delivery of gas transmission capacity for Milford Haven. Therefore, to the extent that there is a risk that the timing of the price control review could weaken or negate these incentive arrangements it is clearly important that this issue is considered ahead of any revised incentive arrangements being introduced in April 2007. However, we are unsure how arrangements that may be progressed as a result of this consultation process would fit with final TPCR buyback incentive arrangements. That is, is it anticipated that they would co-exist or would they be superseded by the final TPCR proposals?

2. *Are the principles identified in paragraph 4.3 an appropriate basis for new incentive arrangements?*

Yes, we believe the principles identified are appropriate. Given the user commitment required to secure the provision of incremental entry capacity through the long term auctions, it would appear appropriate that NGG NTS (not customers) should be exposed to the cost of late delivery. Certainly, NGG should be encouraged to deliver additional NTS capacity in a timely and cost effective manner and we believe this should take account of both its investment costs and the economic costs of disruption to the LNG supply chain at Milford Haven. We therefore believe that there should be a market price for buyback rather than administered price, although we recognise that unlimited liability is not a realistic option.

3. *Should NGG NTS's exposure to buyback costs be deferred if there are undue delays due to consents for the construction of the reinforcement of pipelines, adverse weather conditions or other exceptional factors?*

It would seem inappropriate to introduce an incentive scheme that penalised NGG NTS in exceptional circumstances or those that are outwith their control. For example, delays that are genuinely associated with the consents and planning application process itself. That said, it would be clearly inappropriate to introduce an incentive scheme that did not encourage NGG to progress planning and consent processes proactively.

4. *What are the advantages and disadvantages of the new incentive arrangements described in this chapter?*

In our view, the main advantage of the incentive arrangements described is that they seek to strengthen the incentive on NGG NTS to deliver the new capacity on time and that it would afford additional protection to consumers from buyback costs. Of the options presented in table 2, monthly caps would appear to provide a stronger incentive when compared to quarterly caps. Options C and D provide a longer incentive period than options A and B which we believe is appropriate and of the two, we consider option C is likely to provide the strongest incentive.

5. *Should this deferral "skip" the period November – February during which construction is not practicable?*

We are unsure why there is a view that construction between November and February will not be possible given recent weather patterns. Therefore we do not believe that it is appropriate for there to be an automatic deferral of the incentive over these months. To the

extent that following the event the weather over this period turned out to be exceptional and work was prohibited, it may be necessary to take account of it at that time.

6. *What are the advantages and disadvantages of the new incentive arrangements described in this chapter?*

We believe that this is a repeat of question 4. above.

7. *Are there further steps that should be taken to encourage NGG NTS and the relevant shippers to enter into arrangements that would minimise the economic costs of any delay in the provision of transmission capacity at Milford Haven?*

As we have mentioned in the opening section of this response, we believe that the entry capacity arrangements are already very complex and we would be concerned if, going forward, further regulatory intervention meant that this complexity was exacerbated.

I hope that you will find these comments helpful

Yours sincerely

Rob McDonald  
**Director of Regulation**