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17th March 2006

**3rd Party Proposal: Publication of Near Real Time Data at UK sub-terminals. Modification
Reference Number UNC 006 - Impact Assessment**

Dear Sonia,

This letter covers the response of RWE npower and RWE Trading to Ofgem's Impact Assessment (IA) into UNC Modification Proposal 006 published on the 3rd February 2006.

Despite initially giving our qualified support to the modification proposal we do not now support it as we do not believe that publishing snapshot information of actual flows at sub terminals on a near real time basis will lead to any appreciable incremental benefit to market participants.

The concerns we have with the modification proposal and the reasons we do not support it are laid out in our previous responses on this subject¹ and we do not intend to re-visit these here.

Instead we shall limit our comments to the IA itself and the questions raised within.

Has Ofgem undertaken the appropriate analysis?

Ofgem's attempt to quantify the benefits arising from improved economic signals is welcome bearing in mind that their initial IA relied on a qualitative estimate of these benefits.

Ofgem's price model appears to show a good correlation between estimated price and SAP over the fifteen months investigated. However it is not clear whether the same levels of correlation would exist between estimated price and SMP Buy which, because of the volatile nature of within day prices and the assumption that prices are being adversely impacted by rumour, may have been a more appropriate comparator to use.

It would also be interesting to know whether Ofgem's price model stands up to the unprecedented levels of volatility seen in the market over the last week.

¹ Response to Mod Proposal 006 (727) dated 2/3/2005;
Response to Initial Impact Assessment dated 24/6/05;
Response to Open Letter on the proposal dated 14/11/05;
Response to Case Study dated 16/1/06

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In the absence of further explanation of the beach risk co-efficients, the assumptions behind the extent to which these have been lowered in the large, medium and small outage scenarios and the volume assumptions built into the model, it is not possible for us to determine how the high, medium and low impact benefits have been calculated.

Is there any additional analysis that would have been appropriate?

We believe Ofgem's IA would have benefited from analysing the levels of bid/offer spread, volatility and liquidity that has existed in traded markets since July 2005² and making assumptions about how this modification proposal would incrementally affect these parameters.

This would help interested parties to make more informed quantitative judgements of the likely market efficiency benefits/costs of this proposal compared to Ofgem's price model conclusions.

Do you think the assumptions used in the modelling were correct?

It is difficult for us to comment on this without more detailed information about what these assumption were. However, to the limited extent the assumptions are described in the IA we would make the following comments.

We are surprised Ofgem's price model did not appear to include the gas/electricity spark spread as a function of GB prices, and that temperature seems to be the only demand side driver.

We also wonder whether the assumption derived from the model that a 1 mcm increase in beach supplies gives rise to a 0.00366 p/therm increase in price holds true when the system is under stress (which is the point at which one would assume incremental offshore information is at its most valuable), or whether the inverse of this assumption is correct.

Are the benefits obtained from the modelling analysis reasonable?

As we have not been able to fully understand the detailed assumptions contained in Ofgem's price model, or how this model was used to derive the low, medium and high case benefits resulting from improved economic signals, we can not say whether the benefits obtained are reasonable.

As no further analysis was carried out on the quantitative benefits of system balancing and market volatility we assume that benefits attributed to them in the summary table should be equivalent to those shown in the initial IA. The fact that these have been overstated in the summary table by a factor of ten is we assume therefore due to a typographical error.

Was there value in carrying out the January consultation?

It is clear from the responses to the January consultation that a number of parties felt that they did not have sufficient time to consider the case studies in sufficient detail, and that some parties felt there were obvious flaws in the case study data that needed further explanation.

Nevertheless, we do not believe that those parties who expressed support for the proposal made particularly convincing arguments as to how they would have acted differently or derived benefits were the modification to be in place, when presented with actual historical examples of outages.

² The point in time at which aggregated zonal physical data was made available to the market on an hourly basis.

Are NGG NTS's cost estimates reasonable?

As previously stated we have no great insight into the workings of NGG NTS's IT systems and as such it is not possible for us to state whether their estimated cost is reasonable.

However, bearing in mind the principle of publishing aggregated hourly zonal data on Gemini and on their website has already been established, we would expect most of the estimated costs to for hardware required to support the exponential increase in the volume of data. System development costs and project resource costs would therefore be expected to be low.

Has Ofgem reached the correct conclusions regarding NGG NTS's cost estimates?

Ofgem were right to request a fuller explanation of the IT costs NGG NTS are likely to incur in the event this modification proposal were to be approved. We would expect NGG NTS to fund any future system development and hardware costs that may be required from their existing allowed SO revenue.

Any development work required by NGG NTS should be undertaken in co-operation with shippers and through the appropriate governance body regardless of the view they may have of its impact on shipper systems. This is because despite previous assurances from NGG NTS that changes to their systems (e.g. Gemini) will not impact shipper systems, this has not always been the case.

Do you agree with Ofgem's overall conclusions regarding the costs, benefits and associated risks?

We do not accept Ofgem's overall conclusions regarding the costs, benefits and risks associated with implementation of the modification proposal.

The principle component of the net benefit stated in the IA, which leads Ofgem to conclude that they are minded to accept the modification proposal, is attributed to improved economic signals, but it is not clear how Ofgem's price model has been used to derive this.

The other quantified benefits derived from improved system balancing and reduced market volatility are in our opinion overstated, and we believe Ofgem have under estimated the risk that market volatility may increase as a consequence of this proposal going ahead.

Whilst we would expect NGG NTS's estimated IT costs to be at the top end of expectations, we note that no account has been taken of the costs large end user customers and shippers might incur in recording and monitoring this data. This may be appropriate as we do not expect many parties to access the data other than through periodically viewing it on NGG NTS's website. However in the event parties do need to continually access and record the data and trigger alerts on the basis of it, then there is likely to be a significant cost associated with this.

It is unrealistic to expect that the full complement of benefits arising from any improved economic signals will materialise if very few market participants are pro-actively using this data, and this casts further doubt on the scale of any net benefit.

We also believe Ofgem have largely ignored the risk to beach shippers, storage users and inter-connector users of becoming distressed buyers as a consequence of this proposal. Whilst it is true to say that even if market participants know there are physical problems at a sub-terminal they will not necessarily know the affected party or their contractual position, this will not stop non physical trading parties front running the market for speculative gain. It is also unreasonable in the current market

environment to expect parties to hold back significant quantities of physical gas to mitigate against any unforeseen shortfalls (as suggested in paragraph 2.55), and in the event they were to do so we believe they would face an increased risk of regulatory scrutiny.

In summary we accept that quantifying the net benefit or cost associated with this modification proposal is not easy. On balance however, we do not believe the IA has made a sufficiently robust or convincing case to justify its implementation, and believe that greater focus should be placed on improving information provision between NGG NTS and terminal operators.

In the event the modification proposal is implemented we believe there would be benefit to all market participants in Ofgem publishing a document on the state of competition in gas wholesale and traded markets ahead of its implementation. Such a document would be expected to take an informed view of such issues as economic signals, volatility, liquidity and market responsiveness and could draw parallels with the equivalent report published for retail markets. If updated periodically it could also be used as a more definitive benchmark for measuring the impact of this proposal and any future proposals that may be expected to impact wholesale and traded markets.

Should you wish to discuss our response in more detail please feel free to contact me.

Yours sincerely,

Steve Rose
Economic Regulation

Sent by e-mail and therefore not signed