

Mark Feather
Associate Director
Ofgem
9 Millbank
London SW1P 3GE

Your ref 23/07
Our ref Log 327
Name Stephen Rose
Phone 01793 892068
Fax 01793 892981
E-Mail stephen.rose@rwenpower.com

6th March 2007

National Grid Gas - Offtake Arrangements Final Impact Assessment of modification proposals

Dear Mark,

RWE npower welcomes the opportunity to comment on the above impact assessment and does so on behalf of all its licensed gas businesses and RWE Trading GmbH.

Our comments below are grouped around the main headings in the report.

Efficient NTS Investment Signals

The majority of the benefits Ofgem perceive will arise from NTS Exit reform relate to increased efficiency of NTS investment. However, it is hard to see why this should be the case at exit points where there is only one connected User and where the requirement for incremental capacity have historically been supported by ARCA's.

It would seem to us that the main purpose of the user commitment envisaged by these proposals is not to avoid stranded assets, but to provide justification for National Grid Gas (NGG) to include the efficient capital cost of incremental investment into their Regulated Asset Base. The fact that Ofgem have failed to take the opportunity to quantify the current level of asset stranding on the NTS makes it difficult to assess whether the proposals will lead to improvements or not.

Requiring Users to provide greater notice of capacity withdrawal may, when combined with a licence obligation on NGG to consider NTS Exit capacity substitution, reduce the obvious possibilities of inefficient investment. However we believe the 6.5% efficiency savings claimed has been overstated and is unlikely to arise purely from increased user commitment.

Non discriminatory allocation of capacity products

NGG already have licence obligations preventing them from discriminating against Users, or any class of User, and we are not aware of any discrimination having arisen in the allocation of capacity (both flat and flexibility) since DN sales.

RWE npower

Trigonos
Windmill Hill Business
Park
Whitehill Way
Swindon
Wiltshire SN5 6PB

T +44(0)1793/87 77 77
F +44(0)1793/89 25 25
I www.rwenpower.com

Registered office:
RWE Npower plc
Windmill Hill Business
Park
Whitehill Way
Swindon
Wiltshire SN5 6PB

Registered in England
and Wales no. 3892782

To attribute any benefit to this one has to assume that NG will discriminate against Users in the absence of any NTS Exit reform, and the probability of this is likely to be small.

In the absence of any NTS Exit reform in the unlikely event a User were to be discriminated against the likelihood is it would refer the matter to Ofgem. To the extent that any benefit is attributable to non discriminatory allocation of capacity therefore, it would seem more appropriate to incorporate this in the benefits arising from reduced incidence of disputes rather than assuming it would result in a certain percentage of the comparative efficiency benefit arising from DN sales being lost, particularly as this benefit was itself an assumption.

Reduced incidence of ARCAs

To the extent that NGG NTS maintain their current ARCA terms then incidences of disputes are likely to be frequent bearing in mind Ofgem's recent determinations that only one year's NTS Exit capacity charge is required for CCGT connections. However, unless NGG could demonstrate a project was inherently more risky one would assume they would take these determinations into account for future CCGT builds, which should reduce the likelihood of disputes arising.

Whilst we accept that reduced incidence of ARCA disputes is a factor worthy of inclusion within the benefits case, it should not be forgotten that ARCA disputes can be about matters other than just the extent of the user commitment.

In the case of the Langage ARCA dispute, issues relating to the connection point, the contract term (fixed or variable) and the costs of connection surveys featured heavily and the extent of the user commitment was a relatively small aspect of the overall determination. Such issues could continue to be disputed even if NTS Exit reform were to proceed as envisaged by these proposals, and the introduction of flexibility creates the prospect of a whole new range of dispute issues to arise.

Shipper Costs

In the same way that it is difficult to estimate potential benefits that may arise from these proposals it is also difficult for shippers, customers and transporters to estimate the costs these proposals will impose on their systems and business operations. The cost data we submitted was based on our best view of the costs we are likely to incur based on our current understanding of the proposals. However, until such time as detailed procedures, business analysis and system specifications are developed we will not know for sure what the full impact will be.

Whilst it is true that in a competitive retail market shippers who incurs higher costs than the norm risk losing market share to shippers incurring less costs if they pass them on fully to their customers, economies of scale should also be considered here. A large shipper is likely to incur larger costs than a smaller one under these proposals but this difference is likely to be proportionally smaller than the difference in size. Larger shippers have larger customer bases to smear these costs over whereas smaller shippers may not be as efficient and, given their smaller customer base, their customers could pick up a much larger proportion of charges per head.

Although it may be an over estimation to assume that shippers would need to have an additional full time trading desk to manage the new flexibility arrangements, increased resources will be required to monitor flexibility availability and usage and to factor this into CCGT running profiles. It is not the case therefore that were the flexibility arrangements to currently be in place, the fact that peak aggregate usage of flexibility has never been above the 22 mcm/day baseline means that such resource would never have been used. This argument also contradicts assumptions Ofgem have made elsewhere in the document

when claiming that flexibility is a scarce product that needs to be efficiently allocated.

Costs to gas transporters and their Agency

Whilst we recognise it is Ofgem's current intention to ensure that NGG NTS, GDN and agency implementation costs should be borne by the relevant GT shareholders, as they relate to DN sales, it is not clear what Ofgem's position is regarding ongoing costs. These costs represent the majority of the total costs incurred by these parties and if included would negate the net benefit of all of the proposals with the exception of modification proposal 116CV.

If ongoing costs are to be excluded, along with implementation costs, we would expect Ofgem to clearly state what measures they intend to put in place to ensure there is no seepage of these costs into those general costs which are subject to price control, and that there is no inappropriate usage of price controlled resources to manage the allocation of flat and flexibility capacity.

Qualitative Analysis

We are surprised that Ofgem believe that qualitative benefits should be given equal consideration as quantitative benefits, although bearing in mind the assumptions made it could be argued that the benefits case is wholly qualitative.

Efficient network development and system operation

We refute the suggestion that the introduction and allocation of flexibility capacity will reduce the need for NGG to take within day balancing actions to manage flow variations. NGG already have powers under the UNC to prevent Users making flow variations if this would result in a balancing action.

We see no reason why CCGTs should be unable to access flexibility going forward absent any NTS Exit reform and so do not believe this could lead to increased electricity balancing costs. In fact the opposite is likely to be the case, as the introduction of the flexibility is likely to complicate and potentially reduce participation in the balancing market leading to higher electricity balancing costs.

Promotion of competition

We are sceptical whether the introduction of the proposed NTS Exit reforms will have a positive impact on effective competition and believe it is at least as likely that it will have the opposite effect. In particular the proposed flexibility auction arrangements are unlikely to promote competition between parties as flex is not currently short supply. However, as the level of baseline flexibility being auctioned is less than is likely to be available on most days, and as User's requirement for flexibility is likely to unpredictable and non co-incident, there is in our opinion a possibility that an artificial scarcity of flexibility will be perceived. As GDN Users require flexibility to demonstrate compliance with their Safety Case and will pass on the cost of acquiring it to customers on their networks, one would expect them to be in a position where they can outbid other Users for capacity. Such a situation would heighten uncertainty for Users shipping to CCGTs, interconnectors, storage facilities and directly connected end user customers, which could be detrimental to competition.

Simplicity and transparency

Whilst we recognise that there are aspects of the proposals which are simplifications to the arrangements proposed by NGG at the time of DN sales we would also point out that discussions at EOWG included a number of further simplifications which were not accepted by NGG or Ofgem.

Also, at no time in the considerable period during which enduring exit reform has been discussed has any shipper or end user customer accepted the need to disaggregate the allocation of flat and flexibility capacity.

Ensuring security of supply

In our opinion the respective roles of NGG NTS and network users are already sufficiently well defined and so we fail to see how the approval of modification proposal 116v can be expected to promote security of supply. Indeed a counter argument could also be made that abolition of long term interruption at NTS level might pose an increased threat to security of supply as less interruption may be available.

Preventing undue discrimination

Whilst we recognise Ofgem's concerns regarding the potential for discrimination that may arise between firm an interruptible sites, the majority of this relates to the GDNs and is being addresses through modification proposal 90 (which we support). At NTS level this could have been addressed by way of a similar modification without introducing the extra complexity associated with modification proposal 116V.

As for discrimination between classes of users it is not the case that under the transitional arrangements TCCs are allowed unlimited use of flexibility due to the restrictions contained in NExA and UNC (Section J.4.5.7). Whilst GDNs currently acquire (as opposed to purchase) flexibility capacity separately under the traditional arrangements they do have considerable flexibility to vary flows between offtakes. Also, we are not aware that NGG NTS actively measures their use of flexibility on an ongoing basis or that any GDN has complained about any restrictions placed on their use of flexibility during this period.

Health and Safety

We note that the HSE has advised that these changes, if implemented, are likely to require material changes to the NGG NTS, DN and NEC Safety Cases. Whilst we recognise that this is primarily an issue between the HSE and transporters we would expect shippers to be provided with an insight into these discussions, as on previous occasions changes to the Safety Case have led to transporters raising modification proposal they then regard as a "fait accompli".

Risks and unintended consequences

Bearing in mind the potential risks and unintended consequences arising from NTS Exit reform it is disappointing that Ofgem have not attempted to attribute probabilities to certain outcomes that support the benefit case, as recommended recently by the House of Commons Public Accounts Committee.

Probabilities could also have been attributed to risks and unintended consequences such as reduced capacity being delivered due to a user commitment model or a flawed incentive scheme, seepage of transporters ongoing costs and increased balancing costs.

We agree that one of the possible unintended consequences of enduring offtake reform could be that the increased complexity of the arrangements could constitute a barrier to entry into the shipper market or increase the difficulty that customers face in switching suppliers. Bearing in mind the concerns that have already been expressed by I&C customers about the reduced number of suppliers able to meet their requirements this should risk not be underestimated.

Should you wish to discuss our comments in more detail please do not hesitate to contact me.

Yours sincerely,

Steve Rose
Economic Regulation

Sent by e-mail and therefore not signed