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National Grid Gas NTS price control allowance for xoserve

Dear Bob,

RWE npower welcomes the opportunity to comment on the open letter dated 20th December 2007 regarding the above, and does so on behalf of all its licensed gas businesses.

We have no reason to doubt Ofgem's assessment of the efficiency of xoserve's costs that was undertaken as part of Gas Distribution Price Control (GDPCR). As such, Ofgem's proposed allowances for xoserve's operating costs and for Gemini/UK Link infrastructure upgrades and maintenance seem acceptable.

We do however have concerns about the implications of Ofgem's user pays approach to xoserve funding, and the impact of this on industry framework changes relating to both transmission and distribution activities.

We were disappointed that Ofgem chose to pursue a user pays approach to xoserve funding bearing in mind the inadequacy of the impact assessment undertaken in support of this decision and the significant work involved in establishing governance arrangements for the limited number of user pays service lines. We have also expressed concerns that as no system development costs appear to have been included in xoserve's funding under GDPCR, GDNs/xoserve will use this to argue that every variation to core services should be treated as user pays. This in our opinion is likely to result in inefficiency in industry framework development going forward and GDNs having little incentive to improve the core services they provide to shippers via xoserve.

It is disappointing to see that Ofgem seem to be taking the same approach under Transmission Price Control (TPCR), by disallowing development costs associated with industry framework changes relating to transmission. Whilst Ofgem are right to be cautious about allowing costs of a speculative nature (such as within day cost targeting of entry/exit profiling and change of gas day times to facilitate cross border trading) to be included in TPCR, we are strongly opposed to Ofgem disallowing the relatively modest costs (£600k p.a. or £1.6m over the four year period after application of the probability factor) associated with shipper driven

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modification proposals.

To do so will unnecessarily complicate the governance process surrounding transmission related modification proposals and stifle industry framework development in this area. Whilst Ofgem have, unwisely in our opinion, taken a similar approach in distribution we do not see any compelling reasons why consistency need apply. User pays was a concept introduced under GDPCR and, to the extent it is appropriate at all, it would seem most appropriate in the context of suppliers competing in retail markets through product and service differentiation. The limited number of user pays service lines the industry has been able to identify are almost exclusively related to retail market activities, and are likely to remain that way. To impose the user pays concept on NG NTS, and potentially stifle development of transmission related activities (which mostly impact the wholesale market) simply to ensure regulatory consistency would be a retrograde step.

Ofgem are proposing to allow a total of £2.5m of costs relating to "Exit Reform - Flat Capacity" in xoserve funding. We have no basis on which to assess the efficiency of these costs and are unsure why these costs have been allowed, bearing in mind Ofgem's previous statement that the costs associated with the implementation of enduring offtake arrangements should not be passed through to customers as such costs represent a cost of the GDN sale transaction. If these costs represent ongoing operational costs rather than implementation costs, they look on the face of it to be high (particularly in the first year). Also, we would not expect any operational costs to be incurred by xoserve/NG NTS until 2009/10 at the earliest bearing in mind the current status of enduring offtake reform.

Finally, whilst we understand the simplicity associated with disallowing NG NTS's share (11%) of xoserve's costs of providing the currently agreed user pay service lines (£2.83m p.a.), this seems unfair bearing in mind these service lines are largely unrelated to transmission activities. Excluding these costs (£311 k p.a.) as well as the costs associated with shipper driven modification proposals, will increase the likelihood of industry framework development grinding to a halt due to regular and protracted arguments arising between shippers and NG NTS about who should fund changes to the industry systems and process on which the competitive wholesale market depends.

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