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RWE npower's response to Ofgem's Quarterly Price Report

Dear Ed,

Thank you for the opportunity to comment on the Quarterly Price Report. We acknowledge that Ofgem has put time and resource into the modelling of the relationship between wholesale and other costs and customer bills as well as supplier margins. We also appreciate that the Report attempted to advance the calculation from suppliers' gross margins to net margins. Ofgem has made good progress in tackling a complex issue.

However, we still consider that the modelling requires further development. As we have discussed with Ofgem and NERA's analysis has demonstrated there are a range of cost items that are not included in Ofgem's analysis such as additional trading costs to match demand profiles. There are also a number of assumptions such as consumption levels which will tend to overstate profitability in the present model. These features considerably alter the conclusions to be drawn on a supplier's profits. For example, for a dual fuel customer at November Ofgem calculates the net margin at £85 while NERA estimates it to be a loss of £1.

A great deal of emphasis is being placed on Ofgem's quarterly reports by a range of stakeholders. However, until the modelling is robust, it is important for Ofgem to attach a prominent health warning to its reports. There is potential for significant damage if false conclusions are drawn about the level of profitability. For example:

- Regulators and politicians may seek to impose ill-conceived regulations which undermine the long term interests of customers;
- Customers may be sent false signals about the prospects for prices;
- Potential new entrants may make business decisions on the basis of erroneous information.

Therefore, we would suggest that Ofgem needs to be cautious about drawing firm conclusions on suppliers' profitability from its analysis.

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We commend Ofgem for running this consultation, seeking suggestions for improvements to its method. As part of a rigorous and transparent modelling process, we recommend that Ofgem documents its method in detail and adopts version control which logs the methodological changes from one report to the next. Making this information available to other parties would contribute to developing the reliability of the model.

Yours sincerely

A handwritten signature in black ink, appearing to read "Charles Vann". The signature is fluid and cursive, with a long horizontal stroke at the end.

PP David Mannering
Director of Economic Regulation