RWE npower

Andrew Fox
National Grid
UKT Commercial – Floor B3
National Grid House
Warwick Technology Park
Gallows Hill
Warwick CV34 6DA

Your ref
Our ref
Name Charles Ruffell
Phone 01793 89 39 83
Fax 01793 89 29 81
E-Mail charles.ruffell@rwenpower.com

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Entry Capacity Substitution Methodology Statement
July 2009

Dear Andrew,

We welcome the opportunity to comment on this consultation. The response is provided on behalf of the RWE group of companies, including RWE Npower plc and RWE Supply and Trading GmbH.

The proposed Entry Capacity Substitution Methodology Statement (ECS) under consultation is based upon the "Options Approach" and does not consider either of the other two potential methodologies that have been developed. Ofgem's open letter[1] notwithstanding, we believe that these alternative methodologies must be considered as part of any Impact Assessment given their level of development. It is unreasonable to exclude them and the principles of each methodology should be assessed. In light of the clarification provided by Ofgem[2] on how the substitution obligation interacts with other statutory duties and licence obligations on National Grid we think it is entirely appropriate that National Grid should use broad assessment criteria to inform its investment decisions and nothing should be ruled out at this stage.

Although we have consistently supported the principle of substitution, this has been tempered by our concerns about capacity destruction and the consequent reduction in the flexibility of the NTS. With declining UKCS supplies and the key role that new gas-fired generation is expected to play in the medium term, it is vital that GB has access to gas from international markets. We are therefore keen to avoid policies that undermine security of supply and may introduce additional market uncertainty that adversely affects investment in new energy infrastructure. On this basis, our preference would be for the Impact Assessment to consider scenarios of the effect on commodity prices caused by reduced access to capacity on peak days and the impact on GB consumers. A starting point might be the impact on winter prices caused by the temporary reallocation of capacity after the first transfer and trade auction.

[1] Development of a methodology to implement National Transmission System (NTS) Entry Capacity Substitution, July 2009
[2] Informal consultation on National Grid Gas's National Transmission System (NTS) Gas Transporter licence condition with respect to Entry Capacity Substitution, July 2009

RWE npower

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

T +44(0)1793/89 39 83
F +44(0)1793/89 29 81
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

We see little merit in the Retainer Approach as currently drafted, but accept that National Grid has complied with its licence obligations in issuing its ECS based upon this approach. Our specific comments include:

Rights Acquired
Although the retainer prevents capacity being used to satisfy incremental requests at another ASEP, the risk of that capacity being allocated to meet an incremental signal at that ASEP remains. This makes it difficult to assess the value of paying the retainer fee. This problem is exacerbated where a developer wishes to acquire capacity in the future, but may need to take out a retainer at early QSECs to prevent the capacity being substituted ahead of their requirements. Having to commit early will represent a barrier to certain projects and may not actually result in the capacity being protected in any case.

Retainer Refunds
We welcome the proposal to trigger refunds irrespective of which party acquires capacity and this partly ameliorates the risk is of early commitment. However, as refunds will only be triggered by the allocation of capacity in a 42-54 month period this reduces the incentive to make commitments that fall outside that window. Shippers may have a legitimate requirement for capacity that begins beyond month 54, but to make an early commitment inevitably means that retainer is not refunded. We suggest that the approach be modified such that the proposed 42-months tagging for refunds is extended.

Level of Retainer
We agree that the retainer needs to strike the appropriate balance between providing a meaningful level of commitment and not being seen as unduly penal. Given our observations above, we support Option B but would like to state that even this approach leads to a level of retainer cost that is inconsistent with the rights the retainer conveys.

Exchange rate cap
Within zone, substitutions will be on the basis of most favourable exchange rate first, subject to a cap of 3:1 or better. This cap will also apply out of zone and for both, our preference would be for a lower exchange rate. The Impact Assessment should present some sensitivity analysis around the level of cap. As it is now proposed to include partial substitutions to satisfy incremental capacity requirements, adjusting the exchange rate would only change the balance between substituted and funded incremental capacity.

Substitution hierarchy
For both within and outside zone substitutions, we believe that the methodology should recognise the amount of unsold capacity at each ASEP, so those with a greater level unsold would contribute more to the requirement. Certain ASEPs are more vulnerable to being donors than others simply due to where they are located on the network and how they interact with other ASEPs. All ASEPs should face an equal likelihood that their substitutable capacity may be reallocated and introducing additional criteria based on levels of unbooked capacity, rather than pipeline distance alone, will lead to a more equitable and efficient outcome.

We agree that it is important to avoid stranded capacity and unnecessary infrastructure cost, but prefer an approach based upon retaining flexibility but with progressive reallocation of capacity in light of enduring evidence that such capacity is not required. The UKCS is in decline, with the UK becoming increasingly reliant upon imported gas. Given the importance in the GB generation mix of gas-fired stations in the medium term, it is important to maintain investor confidence in the UK as a place to land gas, including LNG, import pipelines and marginal UKCS fields. In process terms, we strongly believe that all options should be considered as part of Ofgem's Impact Assessment, which needs to demonstrate the benefits of implementing substitution. At this stage, we remain to be convinced of the benefits that introducing substitution in the form proposed ahead of the 2010 QSEC allocations will deliver.

We hope these views are helpful and would be happy to discuss them further.

Yours sincerely,

By email so unsigned

Charles Ruffell
Economic Regulation