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NTS GCD 06 – Supply and Demand Balancing Rules in the Transportation Model

Dear Jemma,

RWE npower welcomes the opportunity to comment on the above discussion document and does so on behalf of all its licensed gas businesses.

Setting charges and auction reserve prices that are reflective of the cost of transporting gas on the NTS network is not a perfect science and could only be done with complete accuracy on a retrospective basis. As this is not a practical option assumptions have to be made about supply and demand, gas flow routes, reinforcement costs and revenue allowances and it is inevitable that these assumptions may not transpire in real time. The transportation model introduced under GCM 01 represents National Grid's best attempt to synthesise these assumptions into a transparent and user friendly model for calculating capacity charges. We welcome its continued commitment to challenging the validity of these assumptions and evaluating the impact they may have on the level and variation in transportation charges.

Our responses to the questions raised in the discussion document are included in the attached appendix.

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

Yours sincerely,

Steve Rose^{*}
Economic Regulation

^{*} sent by e-mail therefore unsigned

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Supply & Demand Balancing Rules

Q1. Do respondents consider the preferred option, Rule Three, to be transparent and cost reflective?

Based on the analysis presented Option 3 appears to result in the least amount of average variation in entry and exit capacity charges in response to changes in demand assumptions, although whether it is more cost reflective than any of the other options is questionable.

The prevailing methodology (Option 1) appears on the face of it to represent a logical merit order of supply deliverability on a peak day and could perhaps be said to be the most cost reflective. However, the experience of this winter, where IUK was exporting gas on days when LRS, MRS and SRS storage facilities were withdrawing gas, demonstrates that assumptions, however logical they may seem at the time, may not transpire in real time.

We accept that grouping together certain sources of supply in the supply merit order used in the transportation model is an appropriate step to take in order to dampen some of the swings in charges that may arise because of its sensitivity to the possible flows from SRS storage. To the extent that Option 3 retains the structure of the merit order of Option 1, which seems inherently correct, this could be a pragmatic solution. However, the same could be argued of Option 6 and the analysis suggests that there is little to choose between these options in respect of average variation.

To the extent grouping occurs it is probably not appropriate to adopt a further merit order within the group as this risks reducing transparency and retaining volatility at specific exit points close to the marginal site in the group at which demand and supply balance.

Q2. Do respondents consider any of the alternative options to be more transparent and cost reflective?

As stated above we think there is little to choose between Option 3 and Option 6, both of which retain the structure of the prevailing merit order. However based on experience of LNG importation this winter and our expectation of how this is likely to develop over time, we do not think that placing LNG importation lower down the merit order than LRS storage and grouping it with MRS and SRS storage is a credible scenario (although in real time it could prove valid), and so we are happy to discount Option 5 at this stage.

Q3. Do respondents consider an option differing from those proposed to be more transparent and cost reflective?

There may be a more favourable option to those National Grid have currently analysed and further analysis of existing options may help to reinforce the case that one is most obviously preferable. We have suggested further analysis that might be appropriate in this respect in our response to question 7.

Supply Availability

Q4: Do respondents consider averaging supply data from a number of Ten Year Statements to be an appropriate approach to dampening entry and exit price volatility?

Whilst we are prepared to accept that grouping of supply sources in the transportation model is an appropriate step to take in order to dampen entry and exit price volatility we are not comfortable with averaging supply data from a number of Ten Year Statements, as a complementary or alternative measure.

The Ten Year Statement is an influencing factor in National Grid's investment decisions and represents its best view of future GB demand and supply requirements based on an extensive process of data gathering. As with any forecast, supply and demand may in real time prove to be different. However it represents a transparent and consistent benchmark against which government, Ofgem and industry participants make assumptions and base business decisions.

Data from the Ten Year Statement is used as source data in the transportation model and as a result shippers and end user customers can readily view and model future capacity prices based on best available information. To the extent their capacity prices are expected to vary as a result of forecast changes in gas flows on the NTS this is entirely appropriate providing the assumptions on which the model is based are broadly considered to be cost reflective. However shippers are able to anticipate any such variation and plan accordingly.

The issue of whether capacity prices should be determined based on average (10 year) or single year supply and demand in the transportation model was raised as part of GCM 01 and overwhelmingly rejected. We do not see any reason therefore why averaging of supply data should be introduced as part of any subsequent proposal relating to the supply merit order used in the transportation model.

Q5: For each of the four supply types; Beach, Interconnector, LNG Importation and Storage, which data source do respondents consider to be most appropriate to use for charge setting purposes?

- *Obligated Entry Capacity*
- *Physical Capability*
- *Ten Year Statement*

We believe that the Ten Year Statement is the most appropriate basis for charge setting purposes for all supply sources. National Grid's Ten Year Statement base case peak supply-demand forecast (Figure 4.7.G in the 2008 Ten Year Statement) presumably takes account of obligated entry capacity and physical capability and uses these factors, along with data gathered through the TBE process, to derive its best case view on peak supply availability. It contrasts this with its best case view of peak demand requirements, and the assumptions made about supply merit order in the transportation model should determine the extent to which supply sources are scaled back to match demand for the purposes of setting transportation charges.

Q6: Do respondents consider alternative sources of supply data to be more appropriate?

No

General

Q7: What further analysis would respondents like to be included with any future consultation?

As has been demonstrated this winter certain facilities within a supply sources do not always act in the same manner on high demand days, the obvious example being the differing behaviours of the IUK and BBL interconnectors on a number of high demand days in January. This suggests that further analysis grouping individual supply sources together based on their price sensitivity (where they exclusively land gas at an entry terminal) may have some merit. For example IUK could possibly be grouped with SRS storage and Teesside LNG, although there is a danger that this might introduce too much complexity.

It may also be worthwhile publishing more data about the variability of charges under each option, for example by indicating how many exit points fall within bands of positive or negative rate variation or the

extent to which sites experience positive variation one year and negative variation the next. This would enable shippers to better gauge the extent to which the exit community as a whole would be affected by each of the various options.

Finally it may also be worthwhile artificially increasing demand such that all supply sources are needed, or carrying out sensitivity analysis based on non base case supply and demand scenarios developed as part of the TBE/Ten Year Statement analysis.