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**National Grid Gas (NTS) System Operator Incentives for 1st April 2009
Initial Proposals Consultation
November 2008**

Dear John,

Thank you for providing us with the opportunity to comment on these Initial Proposals. This response is provided on behalf of the RWE group of companies, including RWE Npower plc and RWE Supply and Trading GmbH.

The earlier initiation of the process this year has permitted more extensive consultation to be undertaken and we believe that this has led to a better outcome. In general, we support National Grid's proposals across the suite of incentive schemes but recognise there are still some areas where we have insufficient detailed information to make informed comments. In these circumstances it remains for Ofgem to subject the proposals to an appropriate level of regulatory scrutiny and oversight. Although we agree that longer-term incentive schemes would allow the SO to trade-off operational costs against investments that would reduce costs over several years we still believe that given the operational focus of the SO, annual schemes are generally more appropriate.

Our detailed comments in response to the questions raised in the consultation are appended to this covering letter.

We hope these views are helpful and if you wish to any aspect of our response, please do not hesitate to contact me on 01793 893983

Yours sincerely,

By email so unsigned

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Consultation Questions

Question 1: Do either of the two residual balancing schemes presented better reflect an appropriate balance between driving minimal residual balancing and correct allocation of costs?

We agree that there should be a minimum residual balancing incentive on National Grid. The two alternative incentive schemes proposed change the balance between the Price Performance Measure (PPM) and Linepack Measure (LM). Of the two, we support Scheme B, that retains the existing PPM but adjusts the LM to dilute the incentive to “fine-tune”.

Question 2: Do you have any comments on any aspects of the scheme(s) features or parameters (including the performance target, the daily caps/collars, the balance between the strength of the LM compared to the PPM)?

Scheme B means that linepack could be operated closer to the physical limits of the NTS without removing completely the incentive to limit imbalances carried between gas days. In our view the revised scheme retains an appropriate cost-targetting framework and balance between the two incentive components.

Question 3: Should this incentive be reviewed periodically (e.g. annually) or only when there is a specific need to?

The incentive scheme should be reviewed annually.

Question 4: Do you think it is appropriate to have a separate incentive on UAG? Do you agree that this should be a long term incentive?

As National Grid does not have the same level of direct influence over volumes of UAG as it does over other components within the shrinkage incentive, we think that it is appropriate to find a better way of incentivising a reduction in UAG.

Question 5: Do you agree with the proposed UAG incentive and do you have any comments on the specific proposals outlined (including whether a scheme should be based around gross UAG and whether the proposed target and incentive value are appropriate)?

We agree it is appropriate to unbundle UAG from the overall shrinkage incentive scheme as this may provide National Grid with the flexibility to undertake actions such as more validation witnessing and improve meter assurance and pre-close out activities.

Question 6: Do you believe that any limits should be applied to the proposed scheme? Please describe how best to achieve this e.g. by suggesting a deadband, cap or method for resetting the target?

The type of activities envisaged will take time to deliver benefits and we think that it is appropriate for this to be a multi-year incentive. It is difficult to comment on whether the proposed scheme parameters are reasonable but they should be set at a level where there is a genuine prospect of National Grid incurring business costs against an uncertain outcome..

Question 7: Do you believe there is an alternative proposal that would better incentivise reduction of UAG volumes?

Not one that National Grid could take the lead on.

Question 8: Do you agree with the shrinkage volume forecasts? Do you have any comments to make?

The overall incentive structure of a total cost incentive with a target derived from target volumes multiplied by reference prices relating to the gas and electricity requirements remains appropriate.

Question 9: Do you support using outturn flows at St Fergus as a target driver for the compressor fuel forecast?

Yes as there remains a strong correlation between outturn flows at St Fergus and use of compressor fuel.

Question 10: Is there still a requirement to have bands around the compressor fuel volume target or should the continuous relationship be used?

Based on the data provided, it may be better to use a continuous rather than banded target.

Question 11: Do you believe it is appropriate to review the GCRP uplift?

As the GCRP uplift was set in 2001, it should be updated to take account of current storage costs.

Question 12: On what basis do you believe the GCRP Uplift should be set for 2009/10 (e.g. storage based or market based)?

Given potential volatility of an ex post market-based approach, GCRP uplift should continue to be based on ex ante storage costs.

Question 13: Do you agree that the outturn UAG volumes should be passed through this scheme?

Yes.

Question 14: Do you have a preference between an annual or quarterly scheme (as described in options 1&2)? Under a quarterly scheme how should quarterly caps and collars be set?

On balance we prefer an annual scheme.

Question 15: Do you have any comments on any of the parameters (e.g. caps, collars, sharing factors) of the scheme and the duration that the scheme should be set for (e.g. 1,2 or 3 years)?

No.

Question 16: Given the uncertainty over the impact of OM contestability, do you support passing through the OM holding costs for 2009/10, subject to Ofgem scrutiny?

We support the development of contestability for the provision of OM services. However, we also accept that procurement from non-storage sources is unproven and as different providers will incur costs differently, the commercial framework needs to be developed. We agree that for 2009/10 OM holding costs should be treated on a pass-through basis, subject to Ofgem scrutiny. Provision of OM services from National Grid's LNG storage facilities is subject to a regulatory price cap and we would expect this to strongly influence National Grid's strategy for OM procurement from non-storage services.

Question 17: If not do you have any suggestions on how OM could be incentivised for 2009/10?

See response to question 16.

Question 18: Do you support the proposal to keep the existing OM utilisation incentive?

Yes, but where OM is procured from a range of sources in the future, this may need to be reviewed as different providers will incur costs in different ways.

Question 19: Do you agree with the proposal for the continuation of the existing historic average approach for setting a volume target for gas turbine driven compressors?

At present, there does not appear to be a better measure. Use of this data should be subject to the outcome of the information request related to electrically driven compressors.

Question 20: Which option do you support to best reflect environmental costs associated with the venting of natural gas?

The Environmental Incentive reference price should relate to all components of natural gas and not just the methane component.

Question 21: Do you support the proposed parameters (including the 3.2% target) for an annual Demand Forecasting Incentive?

We believe that National Grid should face sharper incentives year on year. Given the forecasting uncertainties outlined, the target does not appear to be unreasonable.

Question 22: Should the incentive be set for more than one year?

No, it should be subject to annual review and the extent of any real forecasting improvement assessed.

Question 23: Do you agree that the current Data Publication incentive should be rolled forward unchanged?

Our preference would be to remove this incentive.

Question 24: Do you believe this incentive should be set unchanged for the remainder of the price control period (2012)?

See answer to question 24.

Question 25: Should the funding arrangements for upgrading the website be made enduring or be removed?

They should be removed.

Question 26: Do you believe that the package of incentives are designed to drive the desired behaviours from the System Operator, providing the right balance between risk and reward?

Given the changes proposed, the incentive package better reflects those areas that National Grid can influence and should deliver the desired behaviours.

Question 27: Do you have any other comments on SO Incentives?

No.