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Re: Modification Proposal UNC 125 – Draft Modification Report

Dear Julian,

RWE npower appreciates the opportunity to respond to the above proposed modification. However, we are unable to support the implementation of this modification at the present time. While we agree that the Residual Balancing role carried out by National Grid NTS is a necessary and valuable service for the UK gas trading community, we feel that the Draft Modification Report is insufficiently clear on a number of important points and considerably more information is required by market participants.

National Grid NTS has stated in the Draft Modification Report that the costs of provision of collateral for the Residual Balancer role, based on historic use and dependent on gas costs and the extent of the Residual Balancer role, are currently estimated to be in the range of £30,000 to £50,000 per annum. In the absence of any further information as to the size of the collateral itself, we are concerned that this might be insufficient for provision of suitable cover in the event of an extended market price spike and a shortfall on the network.

In such an event, National Grid NTS might then be required to buy large amounts of gas at high prices on the OCM to cover some of this shortfall and it is difficult for us to assess the risk involved without knowing the actual amount of collateral posted by National Grid NTS. We would appreciate it if the actual level of collateral required for the Residual Balancer role, rather than simply the cost of providing such collateral, were made known to us. Our justification for this request is the simple fact that, if an increase in collateral were required, the amount shippers would have to cover for provision of such collateral would also increase and we would like the opportunity to assess the likely size of such an increase under certain market conditions.

In addition, the Draft Modification Report states that APX believes that the implementation of the Markets in Financial Instruments Directive (MiFID) from November 2007 will lower the threshold for definition of a product as an investment from 7 days to 2 days. Although collateral is required for Within Day and Day Ahead trades, we interpret this to mean that collateral requirements are likely to be more stringent (and therefore more expensive) for longer term trades defined as investments. This would then logically be accompanied by an increase in the cost of provision of such collateral.

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However, we do not understand why National Grid NTS would be required to trade further out than Day Ahead for Residual Balancing purposes, except perhaps in the case of a Gas Emergency being declared.

Outside out of such an Emergency, we feel that National Grid NTS' OCM trading for Residual Balancing purposes should be unaffected by MiFID as we would have thought that such trades should all be within the 2 day window. We would appreciate further information with regard to this.

It is also unclear what the arrangements would be if, in the event of a significant market price spike and shortfall on the network requiring National Grid NTS to buy large amounts of gas on the OCM, its posted collateral were insufficient to meet its obligations. If market participants were then responsible for covering the cost of provision of increased collateral in the short term, especially if it were of a considerable size, repercussions for the market participants could then ensue, both from a credit and financial perspective.

The question of our potential liability is also something to be considered. We interpret the Draft Modification Report to mean that liability to market participants is unlimited as far as cost of collateral provision for National Grid NTS in its role as Residual Balancer is concerned. Therefore, whatever cost of collateral provision is required in relation to market price and the extent of National Grid NTS' buying in relation to the Residual Balancer role will have to be covered. How does this link up with existing National Grid NTS incentives related to the Residual Balancer role?

Finally, in the event of such a situation occurring, what would happen if National Grid NTS' existing collateral were suddenly exhausted or deemed insufficient over a period out of office hours, i.e. a weekend or overnight? In the event of such collateral being exhausted or deemed insufficient at such a time, National Grid NTS would be unable to balance the network through purchases on the OCM until office hours resumed and the necessary financial arrangements could be made to increase collateral along with the increased cost of provision of this. Clearly, this could potentially be highly problematic.

We appreciate that National Grid NTS is generally a net seller of gas on the OCM rather than a net buyer, however, it is worth bearing in mind that the network has never really been placed under severe stress and such an event could have considerable ramifications from a collateral point of view.

In summary, RWE npower is not opposed *per se* to the idea of a cost pass through to market participants for National Grid NTS' cost of provision of collateral requirements in relation to its Residual Balancing role. However, while we appreciate and respect National Grid NTS' right to confidentiality as to the details of its existing collateral arrangements, we regretfully feel unable to provide National Grid NTS with what is essentially a blank cheque without the provision of further information and a greater level of transparency.

Please do not hesitate to contact me if you wish to discuss any of the points raised in this response further.

Yours sincerely,

Chris Hill

Gas Codes Analyst