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Modification Proposal 149/149A - Gas Emergency Cashout Arrangements: Keeping the On the Day Commodity Market (OCM) open during a Gas Deficit Emergency (GDE)

Dear Julian,

RWE npower and RWE Trading GmbH do not support either Modification Proposal 149 or Modification Proposal 149A.

Declaration of a Stage 2 GDE by the NEC is a statement that the wholesale gas market has failed to provide a supply/demand balance and in order to avoid a catastrophic loss of pressure in downstream networks the NEC calls upon its statutory powers, rather than relying on commercial incentives, to manage the total system. In such circumstances shippers lose direct control over their physical gas imbalance position and are legally required to co-operate with the NEC regardless of the financial consequences any directions may have on their business. Both of these Modification Proposals attempt to introduce a quasi market solution which it is hoped, but not necessarily expected, may prompt shippers to take actions which alleviate the GDE. In our opinion this is inappropriate and shippers should at this point be subject solely to the NEC's directions in how they manage their physical gas flows to and from the total system, albeit they will still be able to trade gas at the NBP to mitigate their imbalance exposure.

In our opinion it is arguable whether keeping the OCM open during a GDE will, in practice, help to better facilitate the relevant objectives as claimed by both Modification Proposals. Shippers who are short will, one suspects, have had extremely strong financial incentives to buy any gas that is available from non UKCS sources prior to a GDE being declared. Following implementation of Modification Proposal 44 these incentives are likely to persist throughout the GDE, and when combined with the reputational damage associated with being short, it is fair to assume that shippers will be making every possible effort to source any non UKCS gas that is potentially available.

However, to the extent that the OCM could afford shippers with non UKCS gas the opportunity to sell this gas on a fully collateralised market, rather than to a bilateral counterparty, we believe there is merit in keeping the OCM open during a GDE.

Where we disagree with both Modification Proposals is that we believe that the NEC should direct National Grid NTS (NG) to purchase any non UKCS gas offered

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on the OCM rather than relying on shippers to purchase this to mitigate the financial exposure caused by their physical imbalance position. In our opinion it is shippers who should be prevented from making OCM trades during a GDE, not NG. Whilst we would expect the costs of any purchases to be smeared back shippers (to the extent they are collectively able to bear them, otherwise the Government might need to underwrite them in some way) we would not expect these costs to feed into cashout during the GDE. We also believe it is important that only physical offers on the OCM should be taken by NG in these circumstances.

We believe that the NEC is best placed to assess the impact of purchasing any non UKCS gas on the total system imbalance and the extent to which this may help to alleviate the GDE. If the NEC determines that such action is appropriate the NEC, being a single party that is in close liaison with Government and other relevant parties, is more likely and able to take timely decisive action than shippers collectively, which is exactly what the situation requires.

Whilst on the face of it there may be an apparent financial incentive for shippers to purchase such gas, it is by no means clear that they will have a full understanding of their imbalance position. They may also lack the necessary confidence to make what could be a materially high value trade in the climate of fear and panic that is likely to be prevalent at the time.

In the event Modification Proposal 149A were to be implemented, shippers would have no obvious financial incentive to purchase non UKCS gas if the price offered exceeded cashout prices prevailing at the commencement of the GDE. Similarly if Modification Proposal 149 were to be implemented, shippers who are short would worsen their financial exposure by acquiring such gas if by doing so it set a marginal SMP Buy which exceeded that prevailing at the start of the emergency.

Placing the onus on the NEC (who on declaration of a GDE becomes the primary system balancer) to acquire any non UKCS gas that is made available through the OCM provides greater certainty now that action will be taken where appropriate. Until such time as a GDE is declared it is entirely speculative whether either Modification Proposal 149 or 149A will deliver any additional benefits (or not create extra risks) and if so which of the two proposals would be most beneficial. This does not seem a particularly good basis for determining whether either proposal is likely to better serve the relevant objectives of the UNC.

Such an approach also overcomes concerns that have been expressed about gaming and arguably makes the prospect of shipper failure resulting in an accelerated domino effect less likely, or at least more manageable.

For these reasons we do not believe either proposal facilitates the achievement of the relevant objectives sufficiently better than the current arrangements to justify implementation, even though we believe that the OCM open may marginally increase the efficient and economic operation of the pipeline system by enabling another route to market for non UKCS gas. In our opinion further consideration should be given to the idea that the NEC should be made responsible for acquiring non UKCS gas offered on the OCM both in the Transmission Workstream and in the newly constituted DTI gas and electricity interactions task group.

Yours sincerely,

Steve Rose
Economic Regulation

Sent by e-mail and therefore not signed