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National Grid Transco – Potential sale of gas distribution network businesses – Final Impact Assessment

Dear Sonia,

RWE npower welcomes the opportunity to comment on the above Impact Assessment which will form the basis of the Authority's decision on whether to grant consent to NGT to dispose of four of their distribution networks (DNs).

We recognise the Authority's principle duty is to protect the interests of customers by promoting effective competition in gas transportation, shipping and supply. We therefore agree that before consent can be given it must be clearly demonstrated that NGT's proposed disposal of DN assets will not be detrimental to competition and existing and future customers interests.

Ofgem's base case analysis suggests that the net present value benefit to customers could potentially be in the order of £225m were the proposed sale of DN sales to proceed. Ofgem claim to have used conservative assumptions in their base case analysis and argue that if less conservative assumptions were to have been used a high case net present benefit in the order of £500m could arise. However, even if more conservative assumptions were adopted a low case net present value benefit of approximately £80m could still occur.

Our views on Ofgem's analysis of the costs, benefits, options proposed and risks associated with DN sales are set out in the attached Appendix. In it you will see that we question the basis of a number of the benefits and costs arising from DN sales and disagree with the proposals considered necessary to avoid potential inefficiency and undue discrimination.

However based on Ofgem's analysis, and assuming that at least the low assumptions for improvements in controllable opex are adopted by Ofgem when they come to set future price controls, we believe there is still likely to be a positive net benefit using the methodology Ofgem have adopted. This is despite the fact that we believe the consequential benefits that have been claimed should be discounted and that shipper costs may have been under (or overestimated) by as much as 50%.

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Ofgem have reasonably demonstrated therefore that customers are unlikely to be worse off in the event of DN sales. On the basis that Ofgem's assumptions on the benefits to customers are correct (we have noted our concerns) and that there is ongoing analysis of the costs and benefits, we believe that NGT should be allowed to proceed with their proposed DN sales.

However, we are concerned that the proposed timetable for DN sales will not allow sufficient time for adequate consultation on a number of outstanding issues, in particular on the licence changes, incentive arrangements and unified network code changes. Forcing through these arrangements without adequate consultation so as to comply with the current published timetable materially increases the risk that DN sales could lead to a deterioration in service and have an adverse impact on wholesale and retail competition. We would therefore ask that the Authority give serious consideration to extending the published timetable by three months, as this will allow sufficient time to resolve outstanding issues and complete all the necessary legal drafting with due consideration.

We believe that it would be possible to further increase any potential net benefits arising from DN sales by not introducing market based exit arrangements into the unified network code at hive down. This will remove a significant proportion (possibly up to 50%) of the estimated potential shipper costs from the equation. Even if you believe that by doing so you will remove the potential for the consequential benefits to occur (which we do not as we do not believe these are not valid benefits in the first place) the avoided costs outweigh the consequential benefits (even assuming that shipper cost may have been over estimated by up to 50%).

DN sales represents a fundamental change to the structure of the gas industry. Whilst having the potential to create net benefits to customers it will undoubtedly increase the costs and risks faced by shippers/suppliers, and has the potential to adversely impact security of supply in both gas and electricity. It will also create significant benefits to NGT's shareholders and so it is important to consider the customer benefits in this overall context. Even under Ofgem's most optimistic scenario, the average benefit per customer amounts to roughly 3p per week over 18 years. This will count for little if customers associate any deterioration in service or a reduction in wholesale and retail competition with the decision to allow DN sales to proceed.

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

Yours sincerely,

Steve Rose
Economic Regulation