

Development of Indexation Methodology

A decorative graphic consisting of three overlapping diamonds (rhombuses) arranged in a horizontal line. The diamonds are white with a blue outline and a subtle blue shadow, creating a 3D effect. They are centered on the slide.

Malcolm Arthur

Transmission Commercial

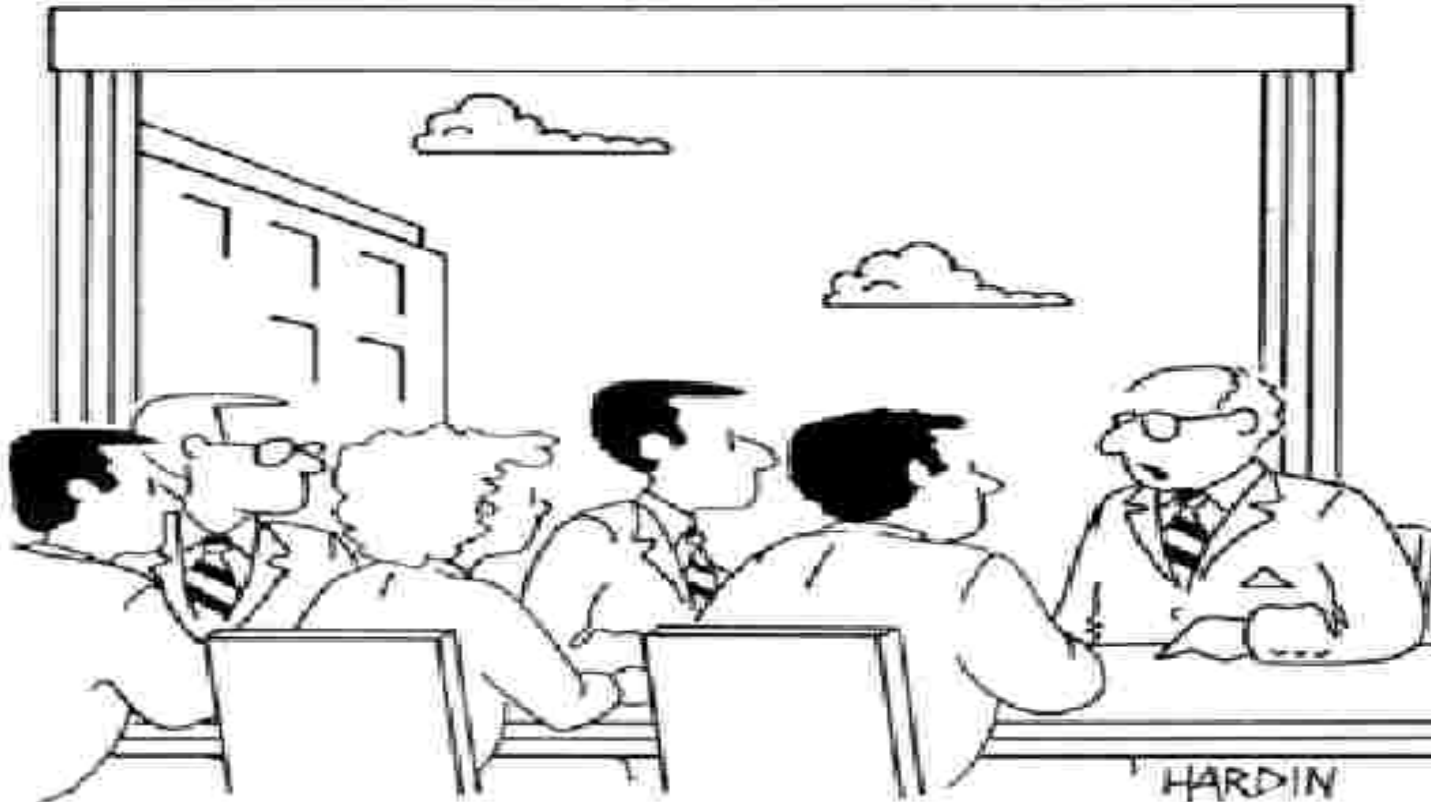
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Agenda

- ◆ Indexation overview
- ◆ Consultation Responses
- ◆ Incentive development timetable

Indexation Consultation – Managing Risk



"We've considered every potential risk except the risks of avoiding all risks."

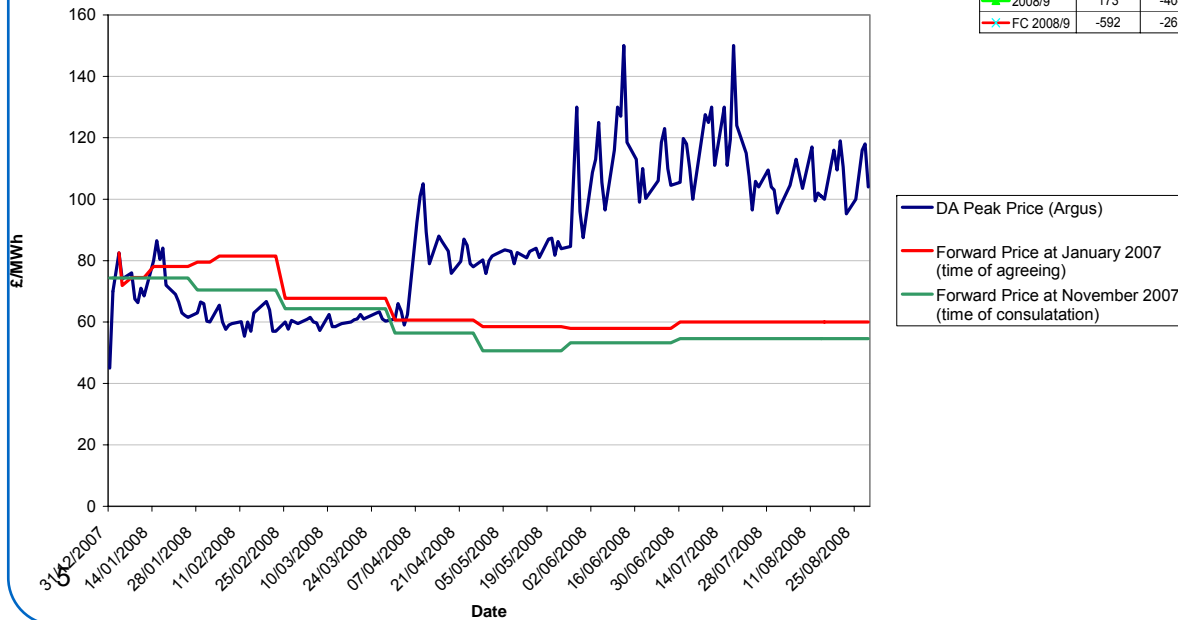
Indexation Overview

- ◆ Aiming to develop a robust methodology to index incentive costs against power price and market length
- ◆ Published consultation on the development of an index
- ◆ Consultation closed on 3 October

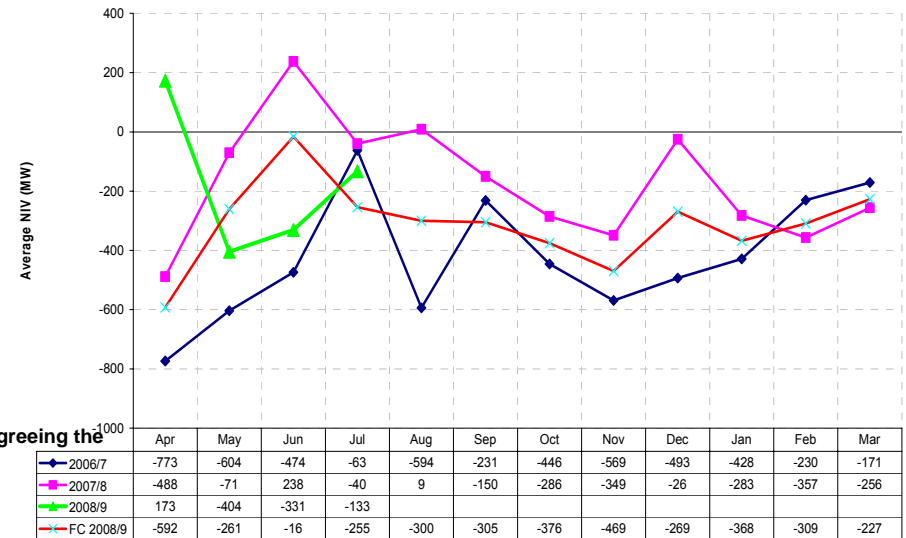
Power price and market length

◆ Volatility of market length

Comparison of Power Outturn Price versus Forward used at time of consulting and agreeing the Incentive Scheme



Monthly Mean NIV

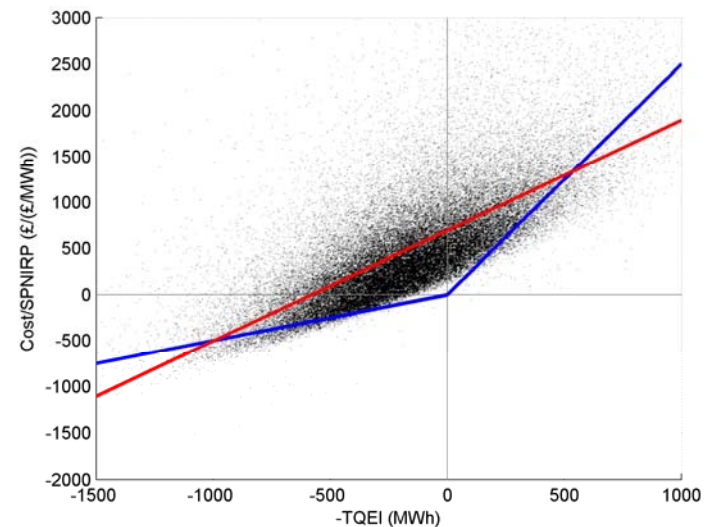


◆ Power price volatility

Development of indexation for 2009/10

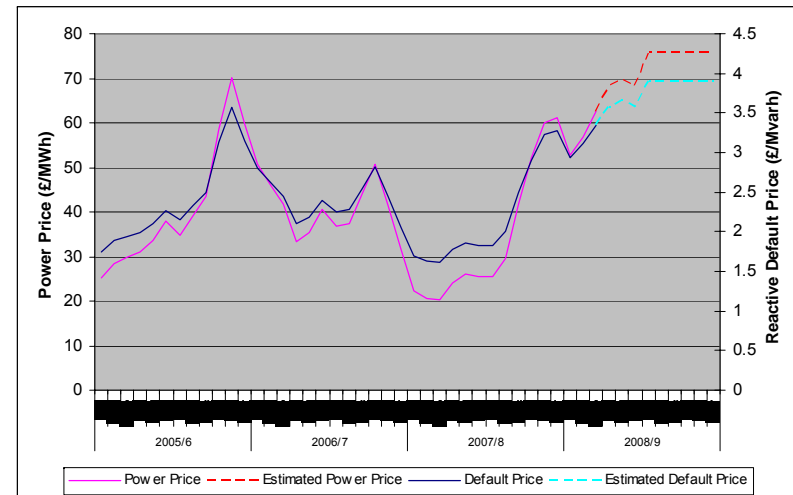
- ◆ A number of potential different indexes proposed
- ◆ Energy, reserve and response indexation; reactive index and a response index
- ◆ Energy, reserve and response indexation
- ◆ Dependant on power price and market length, index would affect costs that were included in the target
- ◆ Regression analysis on relationship between BM reserve, energy and response costs (including ancillary response costs) provided the following index:

$$6 \quad (679 \times \text{SPNIRP}) - (\text{SPNIRP} \times \text{TQEI})$$



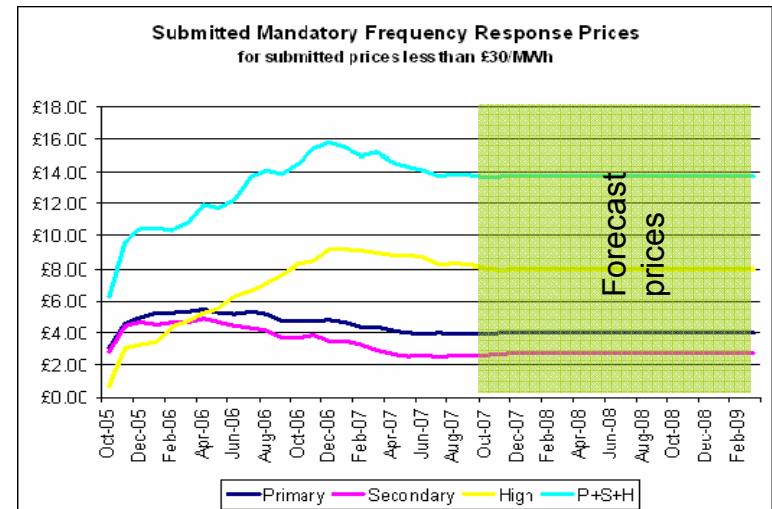
Development of indexation for 2009/10

- ◆ Reactive index
- ◆ Uses monthly reactive power price to update reactive incentive target
- ◆ Volumes are fixed for the year
- ◆ Effectively means that we are incentivised on reactive volumes
- ◆ Only effects default arrangements



Development of indexation for 2009/10

- ◆ Ancillary response cost index
- ◆ Uses monthly submitted prices to update response incentive target with respect to the forecast reference price
- ◆ Volumes would be fixed
- ◆ Effectively means that we are incentivised on lowering volumes and beating the 'reference' price
- ◆ Only effects ancillary response arrangements



Preliminary Consultation Feedback

- ◆ There were 4 responses
- ◆ The majority of respondents stated that they
 - ◆ Agreed with the principles of indexation
 - ◆ General agreement with the proposed method of indexation
 - ◆ No support for separate energy, reserve or response indices
 - ◆ Some concern with the implementation in April 2009
 - ◆ Mixed opinion on the potential for unbundling components
 - ◆ Concern with multi year deals; robustness of proposed indexation and the potential for IAEs

Preliminary Consultation Feedback

- ◆ Some clarification required on:
 - How the index would be applied in practice
 - What the incentive target would look like
 - Effect of index on previous years potential profit / loss

Indicative timetable

26 June 2008	Industry workshop
4 September 2008	Indexation Consultation
October 2008	Fixed Price BSUoS proposals consultation
Early November	Initial proposals consultation
February 09	Final proposals - Ofgem
1 April 09	New incentives go-live

Contact Details

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