



First Hydro Company is part of a joint venture between
International Power plc and Mitsui & Co., Ltd.

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Duncan Burt
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25 January 2008

Dear Duncan,

Electricity System Operator Incentives – NG Initial Proposals Consultation

Please find attached responses to the questions raised in the Initial Proposals Consultation. These comments are limited to the Electricity scheme, and are provided on behalf of all of the International Power / Mitsui assets in the UK.

If you have any questions on our response then please do not hesitate to contact me.

Yours sincerely,

Kevin Dibble
Director, Marketing (First Hydro)

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International Power Mitsui Response to Initial Proposals Consultation

Electricity Related Questions	
1	<p>Do you agree with the assumptions (described in detail the appendix) used to forecast the various elements that make up underlying balancing costs?</p> <p>In general terms we agree that costs look set to increase for 2008/9 as a result of the impact of the LCPD, additional intermittent generation, and the planned transmission outages on the Cheviot boundary.</p> <p>In particular the assumptions on increased costs associated with wind and LCPD are in line with our expectations. We are unable to comment on the forecast constraint costs without further information.</p>
2	<p>In particular, do you have any comments on views on National Grid's forecast assumptions for cost drivers:</p> <ul style="list-style-type: none"> i. The behaviour of NIV during 2008/09 can be expected to be broadly in line with that seen during the current year, 2007/08. <p>We understand that NG is actually assuming a slight increase on NIV for next year, due to the effect of 'normalising' short conditions observed in Summer 2007. In fact, we see no reason why NIV assumptions should not be the same as 2007/8 outturn – the long term trend is to a more balanced position, but we believe that this is levelling out.</p> <ul style="list-style-type: none"> ii. That the forward price is the most appropriate figure to represent the likely outturn wholesale price during 2008/09. <p>This is the most appropriate figure.</p> <ul style="list-style-type: none"> iii. That wholesale power price either directly drive or act as an appropriate proxy to index certain balancing costs. <p>This is certainly, and directly, the case with respect to Reactive Power fees. We also acknowledge that there is a link between wholesale prices and balancing mechanism prices, however the relationship is difficult to establish – and may not be enduring.</p>
3	<p>Do you agree with the assumptions used to forecast Cheviot and Scottish constraint costs, and the costs associated with the forecast rise in Wind output in 2008/09?</p> <p>We do not have sufficient information to validate the constraint costs included in NG's forecast. The costs associated with increased wind output are relatively modest, and seem to be justified through the analysis on mean generation error presented. The forecast therefore looks sensible, and in line with our own assessments of the potential impact of intermittent generation on system operation.</p>
4	<p>Do you have any comments on our initial analysis of the likely impact of the introduction of the Large Combustion Plants Directive, in particular on the likely operation of opted-out plant?</p>

	<p>We believe that operators will very quickly alter behaviour in order to optimise around the new constraints introduced by the LCPD. Unit pricing will need to reflect opportunity costs associated with consumption of limited 'stack' running hours. It is possible that resulting SO costs may be higher during 2008 than in subsequent years, as there are additional units that have opted in to the LCPD but are operating under temporary reduced operating hours derogations (whilst FGD construction is completed.)</p> <p>We understand that NG is considering new procurement processes in relation to opted-out coal units. It is important that any developments in this area include full transparency in order that the rest of the market has visibility of pricing behaviour, and the price stack available to NG in the provision of operating margin.</p>
5	<p>Do you have any comments on the forecast range of incentivised balancing costs and BSUoS costs for 2008/09?</p> <p>The major uncertainty appears to be outturn constraint costs.</p>
6	<p>Do you agree with the main areas for efficiency identified by National Grid?</p> <p>??</p>
7	<p>Do you agree with the range of proposed scheme options? Are there alternative scheme structures that should be considered fro 2008/09?</p> <p>The range of options presented appears to cover a fairly narrow set of outcomes. Given the uncertainty associated with significant areas of the forecast, we would have expected a wider spread of target values.</p> <p>We also note that the caps and collars are modest in comparison with, say, 3 years ago. We think that this is sensible, but more information on which costs are 'controllable' from NG's perspective might have been useful in justifying these risk parameters.</p>
8	<p>Do you support the use of indexes for the 2008/09 incentive scheme</p> <ul style="list-style-type: none"> - Do you agree with the proposed level of scheme target indexation for wholesale power price? <p>We are not convinced on the proposed level of power price indexation. We agree that the Reactive Power element should be indexed (as this is clearly a 'pass-through' cost through the CUSC payment definition) but in relation to BM costs, it is critical that the index relationship is clear and predictable in order for the proposal to operate effectively. We do not feel that this has been sufficiently demonstrated.</p> <ul style="list-style-type: none"> - Do you prefer wholesale power price index option (a) or (b)? <p>If power price indexing for BM costs were to be implemented then Option (a) should be applied.</p> <ul style="list-style-type: none"> - Do you agree with the proposed level of scheme target indexation for Cheviot outage weeks?

	<p>We do not agree with indexation in this area. In order that there is an incentive in place on the Transmission Owners to manage these outages efficiently, the SO must be exposed to any related market costs. This will force the SO and TOs to consider additional initiatives that may result in reduced costs to market participants and the consumer of these outages.</p>
9	<p>Which is (are) your preferred scheme(s)? (please provide reasons)</p> <ul style="list-style-type: none"> - If your preferred scheme is scheme 3 or 4 do you consider these should have a target indexed to power price and/or Scottish outage weeks or not? <p>Our preference would be for Option 3 with no Cheviot outage index, and partial power price indexing as described under question 8.</p>
10	<p>Do you agree that longer term development of systems that will reduce the cost and carbon impact of operating the system be supported? Which manner of funding do you consider to be the most appropriate?</p> <p>The link between this cost incentive and carbon impacts is not clear to us. To what extent may the SO justify additional costs in order to seek reductions in carbon emissions? The energy markets already factor in the cost of carbon via the EU ETS, and any additional actions taken by NG have the potential to distort efficiency in carbon abatement.</p> <p>We note that NG refers to a number of demand-side frequency response technologies that seek ‘seed’ funding in order to demonstrate commercial viability. We further note that this is a significant departure to existing procurement guidelines, and would require a licence change to be implemented.</p> <p>In general we do not think that it is appropriate for NG to provide development funding to companies in this manner. It has the potential to compromise its role in facilitating open and fair competition in the provision of services.</p>
11	<p>Did you find the level of information within this consultation, and associated documentation and workshop, on our balancing and BSUoS costs forecasts for the current year and 2008/09 informative.</p> <ul style="list-style-type: none"> - What additional information should National Grid provide to explain better the costs and cost drivers? <p>The level of information, and the revised consultation process has certainly been helpful and more informative than in previous years. On a specific point, given that the forecast methodology had changed from previous years, it would have been useful to present the numbers in the same way in order that comparisons could easily be made.</p>
12	<p>Do you have any further comments on analysis and information provided within the appendices to this consultation or in the further documentation available on our website?</p> <p>Do you have any further comments on any aspect of this consultation in relation to the Electricity SO?</p>

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| | <ul style="list-style-type: none">▪ The impact of NIV on balancing costs – and the consequent impact on IBC through the NIA - warrants further analysis.▪ We believe that Black Start should be excluded from the SO incentive scheme (possibly added to the SO internal costs.) The service duration is long term and costs are predictable. |
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