



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

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Malcolm Arthur
National Grid plc
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2 September 2009

Dear Malcolm,

National Grid Electricity Transmission System Operator Incentives - Consultation on the Development of Incentives for Reactive Power, Transmission Losses and Black Start

Please find attached a response to the questions raised in the Development of Incentives for Reactive Power, Transmission Losses and Black Start Consultation. These comments are provided on behalf of all of the International Power/ Mitsui assets in the UK.

Our principal observation is that we support the development of indices that are demonstrably robust. However, it is only with reactive power that there seems to be a good chance of developing such a robust index. Our second observation is that unbundled schemes risk adding complexity without the benefit of incentivising overall cost exposure more accurately. Thirdly, multi-year schemes are unnecessary: if there is a broad framework, alongside the expectation of a suitable incentive scheme, then there is nothing to prevent NG investing over longer periods and achieving a return on that investment.

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

Yours sincerely,

Andy Rimmer
Trading Analyst

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1 What benefits do you see for the development of an indexation methodology for reactive power costs? What drivers should be included in such an index?

The principle of indexation is generally a sound one; it should be followed in order to more accurately reflect, and therefore incentivise, those costs that NG is able to control. However, any proposed index must be demonstrably robust.

As in our responses to previous consultations, we believe that it should be possible to develop an index with regard to reactive power. It is clear that NG has no control over certain cost drivers such as RPI and power prices; it should be simple to reflect both of these drivers more accurately than the current one-off annual forecast.

There should not be a separate, unbundled reactive power incentive scheme.

2 What benefits do you believe there are in the implementation of a longer than one year scheme?

Longer schemes may produce benefits if they encourage investments in cost abatement projects which would not be otherwise delivered. However, it should be noted that through establishing an Incentive Scheme framework that more accurately reflects controllable costs then there is nothing to prevent NG investing over longer periods and achieving a return on that investment (such as investment in enhancing IT systems). With such a framework already in place, a longer term scheme does not seem justified at this time.

3 Are there any additional benefits or drawbacks in the development and implementation of an unbundled reactive power incentive?

Implementation of unbundled schemes introduces further administrative complexity into what is an already complex scheme. Further, bundled schemes ensure that focus remains on minimising overall costs.

4 Please provide your views on the development of the reactive power incentive? Do you see any benefits in changing the current arrangements?

We consider that developing a reactive power index is a positive step but it is one that should be included within a bundled scheme. Further, the acceptability of any index would depend on the detailed development; obviously, this detail is lacking at the moment and so this limits any conclusion beyond a high level support for robust indices.

5 What benefits do you see for the development of an indexation methodology for transmission losses? What drivers should be included in such an index?

The principle reason to develop an index is that NG has limited control over transmission losses and that the current scheme does not accurately incentivise the extent of NG's control. It is suggested that an index would incentivise NG more accurately; however, it is by no means clear that it is possible to develop a robust index for transmission losses. Once again, more detail is required in order to establish an opinion.

6 Please provide your views on whether the SO can influence sufficient drivers to reduce Transmission Losses?

The consultation clearly sets out the limited impact NG can have on the drivers of transmission losses and yet the potentially sizeable impact that losses can have on the IBC. Whilst it is important to minimise losses as far as possible, the limited influence of the SO must raise the question of whether it is an appropriate measure to include within the BSIS.

7 What benefits do you believe there are in the implementation of a longer than one year scheme?

As a general observation, multi-year schemes are of limited benefit: if there is a broad framework, alongside the expectation of a suitable incentive scheme, then there is nothing to prevent NG investing over longer periods and realising a return on that investment.

8 Are there any additional benefits or drawbacks in the development and implementation of an unbundled transmission losses incentive?

If losses are to be incentivised then they should be included within a bundled scheme because focus must remain on minimising overall costs and unbundled schemes may affect such focus.

9 Please provide your views on the development of the transmission losses incentive? Do you see any benefits in changing the current arrangements?

We consider that the establishment of a robust index would be difficult and it is perhaps better to devote resources to other matters.

Question 9 Are there any benefits in the development of a TO incentive to manage fixed losses?

The TO's influence over fixed losses seems limited to its decisions on asset investment, given that there is already a requirement to consider low loss equipment it is not clear how any incentive would be developed or indeed what effect it would have. Once again, a detailed suggestion is required before any conclusion could be reached.

10 What benefit do you see in developing a transmission losses zonal forecast incentive?

There is no real benefit to a zonal losses forecast, given the BSC modification being considered and, therefore, any incentive around such a forecast. Further, changes in losses have a small impact on the marginal cost of production and are unlikely to materially affect generation dispatch decisions.

11 What benefit do you see in the development of a Transmission Losses procurement incentive similar to the Gas Shrinkage incentive?

This would be a sizeable change to the current approach to transmission losses and would require much more substantial discussion before a view could be formulated; however, it is an interesting suggestion.

12 Do you agree that National Grid should be incentivised on the procurement of black start services for 2010/11 and 2011/12 as under the current scheme framework?

It is not clear to us that there should be an incentive for the procurement of black start services. However, if there is to be an incentive then there seem few reasons to change the current framework.

13 Do you believe that the black start scheme should be extended to a 2 year target?

If the costs for black start are "reasonably certain" (page 39, paragraph 180) then there seems limited benefit in extending the scheme to a two year target; multi-year schemes are only justified if they lead to lower costs and yet, if costs are "reasonably certain" it is not clear what the benefit will be of a multi-year scheme.

14 How do you believe black start services are best procured post 2012?

We support the current approach being employed by NG in investigating the post-2012 environment for black start services. It is clear that there will be substantial changes to black start costs given the requirement for new providers. NG's investigation should produce a sound basis for a discussion of changes to future procurement; however, we would be interested in viewing the results of the analysis (e.g. the potential for provision from alternate technologies not currently employed) before formulating any conclusions on how the black start services are best procured.

15 Did you find the level of information within this consultation informative? What additional information should National Grid provide to explain better?

The mini-consultations continue the improvement in the BSIS process; the process is becoming more open. However, the consultation seems to be simply about the theoretical desirability of indexation. NG is successful in identifying the drivers of its costs and therefore it should have been possible to propose detailed indices. It is only through detail that the feasibility and robustness of the indexation approach can be thoroughly evaluated.

16 Do you have any further comments on any aspect of this consultation in relation to the Electricity SO?

No.