



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
National Grid House
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7th October 2009

Dear Malcolm,

National Grid Electricity Transmission System Operator Incentives - Consultation on the Development of Incentives for Constraints

Please find attached a response to the questions raised in the Development of Incentives for Constraints Consultation. These comments are provided on behalf of all of the International Power/ Mitsui assets in the UK.

The forecasting and management of constraint costs is a difficult task with a wide margin of error; therefore, this consultation is welcome. It is important to consider ways to improve the incentive scheme with the emphasis remaining on minimising overall costs and it is not clear that the suggestions for unbundling in the consultation further the achievement of this objective. The most appropriate method to achieve a focus on overall costs is a bundled scheme. The three mini-consultations have demonstrated the wide variety of drivers to costs and the significant changes across years to those drivers. Given this unpredictability across years we consider a one year scheme to be the most appropriate method.

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 Do you believe that the drivers for the volume of generation have been identified? How much control do you believe National Grid has on volumes?

The drivers for the volume of generation and the extent of National Grid's influence on the volume of generation have been identified.

2 Have all cost drivers been captured and correctly identified as being within or outside National Grid control?

The cost drivers have been captured and correctly identified.

3 Do you consider that there are elements within these cost drivers that are within National Grid control? What are these and how do you believe these should be considered in the future?

National Grid's risk appetite and approach to contracting can affect costs, for example locking in costs through contracting ahead and its development of new types of contract. The overall effectiveness of the basket of contracts must be evaluated. Given the inherent complexity, National Grid's impact should be considered as part of a bundled scheme.

4 To what extent do you believe that the increase in connected generation behind non-compliant boundaries due to Interim Connect and Manage will impact constraint costs and as such is a key driver.

An increase in connected generation behind a non-compliant boundary will impact constraint costs, all other things being equal. Therefore, Interim Connect and Manage has the potential to be a key driver of constraints; analysis conducted during the TAR process produced the same conclusion. However, it should be emphasised that the uncertainty around the amount of generation connecting is reduced by using a shorter timeframe for the incentive scheme. The wide range of potential outcomes in the connection of generation from a Connect and Manage approach is a strong argument that the length of any incentive scheme should not exceed one year.

5 To what extent do you believe the increase in wind generation will impact constraint costs and as such is a key driver?

There are plans to build a significant amount of intermittent generation behind the Cheviot boundary. This gives rise to the obvious potential for constraint costs/volumes to jump if the increase in wind generation is such that constraints can be resolved only through constraining off wind generation, which due to ROC prices will have negative bid prices. However, the extent of the impact is uncertain and, as the build rate for wind is difficult to predict, this further suggests that a one year scheme should be the maximum scheme length until the impact is fully understood.

6 Do you agree the drivers for constraint costs are significantly different from those of other components of system operation?

The drivers are largely different, although there are some areas of overlap (e.g. impact of BM prices).

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

Unbundling substantially increases the complexity of managing the scheme. The consultation comments that an unbundled scheme will improve clarity of constraint costs. However, clarity can be improved through other methods: improved reporting through the Operational Forum or the Monthly Balancing Services Summary could be developed further and address the clarity issue without introducing unnecessary complexity into the BSIS.

Further, the requirement is noted for a robust and auditable method by which to allocate costs for managing different aspects of the system operation through one action; it is not clear that such a method is achievable. A bundled scheme obviates the need for such a complex, auditable process and maintains emphasis on overall costs.

8 Please provide your views on the methodologies described? Is there an alternative methodology which should be developed?

The methodologies need to be further developed if they are to be used within the BSIS framework; although the BAAR tagging method may be the most appropriate method there are particular concerns about whether this method is auditable. In any future analysis the effects of using different methods must be quantified in order to allow a proper comparison.

9 Do you agree that it would be appropriate to have an adjustment term to mitigate National Grid's exposure to uncontrollable and unpredictable risks affecting constraint costs?

The risk of uncertain connection of new generation can be managed through the avoidance of multi-year schemes and there is no need for an adjustment factor but simply explicit assumptions in National Grid's initial proposals which can then be updated.

As observed in the consultation, an adjustment for the outage weeks on planning boundaries will weaken the incentive to work with TOs in order to reduce overall costs; even with an asymmetrical target this does not seem appropriate based on the information provided in the consultation, more detailed proposals would be required to make an assessment.

10 What items that you believe it would be appropriate for any adjustment term to cover and how would these work?

See answer to the previous question.

11 Please provide your views on the development of an alternative method to manage constraint costs due to fault outages? Is there an additional method which should be developed?

If there is no account of such fault outages in the current scheme then it may be appropriate to include an allowance for fault outages when developing proposals. However, this seems no more uncertain than some of the other cost drivers and so it should be included within a one-year bundled scheme.

The other alternatives considered in the consultation seem unnecessarily complex or expensive; in particular the case for the "insurance pot" idea has not been made and it raises more questions than it answers.

12 Do you agree that development of an alternative treatment for fault outages is appropriate?

See above.

13 Do you believe there are benefits in the implementation of a longer than one year scheme? Please describe your views on the optimal incentive duration for constraints.

A one year bundled scheme is the most appropriate mechanism through which to incentivise NG due to the focus on overall costs. The variety of drivers of constraint costs and the uncertain quantity and impact of new generation connecting leads to the conclusion that the optimal incentive duration is short and a greater than one year scheme seems unjustified at this time.

14 Do you have any comments regarding this consultation process?

- Document structure
- Overall content and level of information provided
- Process

No.