



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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18 September 2009

Dear Malcolm,

National Grid Electricity Transmission System Operator Incentives - Consultation on Developments of the Incentive for the Energy Related Components of the Balancing Services Use of System (BSUoS) Costs

Please find attached a response to the questions raised in the Developments of the Incentive for the Energy Related Components of the Balancing Services Use of System (BSUoS) Costs Consultation. These comments are provided on behalf of all of the International Power/ Mitsui assets in the UK.

Our principal observation is that we prefer a single-year bundled scheme because it enables the interaction between cost drivers to be caught, allows changes in the market to be captured more accurately and ensures that focus is maintained on minimising overall costs.

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 Are there any other risks or benefits associated with the existing 1 year bundled scheme?

The mini-consultation identifies the key risks and benefits of a one year bundled scheme. There are two principal benefits with a one year bundled scheme: firstly, a bundled scheme maintains focus on overall costs and secondly, a one year scheme allows for the changes in the market to be more accurately reflected in the scheme. There seems insufficient justification to move away from a one year bundled scheme.

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

The cost drivers have been identified correctly.

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 going forward?

NG does have some limited influence within these cost drivers; for example, the cost of balancing actions in the BM is influenced by the extent to which NG deems it necessary to employ PGBTs/ warming contracts which can change the type/ cost of plant available in the BM. However, this influence is limited and it is not clear how it should be incentivised.

4 Do you agree that Energy Imbalance, Margin, Footroom, Response and Fast Reserve share the same cost drivers and should be considered together as the Energy component?

They should be considered together as the Energy component due to the similar cost drivers and the interaction between the costs. However, whilst they should be considered together, they should remain as part of a bundled scheme.

5 Do you agree with the need for an adjustment factor to mitigate the risk of variations to cost drivers outside National Grid control?

It is appropriate to incentivise only those costs that National Grid can control. However, this part of the consultation seems a little unclear as it does not include any specific proposals; definite proposals would be required to produce a more useful response.

6 Do you agree that it would be appropriate for any adjustment term to cover the identified items?

It is interesting to see the effect on NIA of considering items such as the energy imbalance costs. It would be useful to see firm proposals considering these items.

7 Are there any other terms that you believe it would be appropriate for any adjustment term to cover? If so, what would these be and how would these work?

The principal terms have been identified.

8 Do you agree that there is a balance between improving the fit and simplicity or should simply the best fit be found?

There is a balance between improving the fit and simplicity: the new NIA represents a significant improvement on the previous method, is a reasonable fit and, yet, remains simple. Whilst, the efficacy of NIA should be monitored and, potentially improved, annual 'tinkering' should be avoided where possible.

9 Which calculation period do you think is more appropriate, daily or halfhourly?

A daily calculation seems to offer a substantial increase in accuracy; it would be interesting to see more information on this calculation, such as the material effect that such a method may have on the

scheme. It has been recognised that there is a trade off between simplicity and improving the fit, it may be useful to indicate the materiality of the potential improvements in the calculation period.

10 Which variables do you think should be included in an improved NIA?

The BST/GMT split would be a small incremental improvement that should be included.

11 What other NIA formats should be considered? Do you believe that there are benefits in including a NIA methodology that has a kinked line?

It seems that there is limited benefit in introducing a NIA that has a kinked line.

12 Do you believe there are benefits in the implementation of a longer than one year scheme?

A multi-year scheme will produce benefits should it lead to NG investing in projects to deliver cost reductions that would not otherwise occur. However, investment can be stimulated in other ways, either through one-off negotiation or through an incentive scheme framework which gives confidence that a return on investment can be achieved. It is not clear that a multi-year scheme is the most efficient way to achieve investment to reduce costs, given the reliance of any multi-year scheme on indices/ adjustment factors. We are sceptical about the possibility of developing an adjustment factor that would be accurate over multiple years.

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

The main drawback of unbundled schemes is that overall costs are not targeted; it is important that attention should be focused on overall costs.

14 Do you have any other comments regarding this consultation?

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

This consultation is more useful than the previous mini-consultation due to the increased level of detail, particularly as regards the NIA analysis. The document is well structured and it continues the improvement in the BSIS consultation process.