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Dear Sonia

Comments on the P194 Impact Assessment

International Power welcomes the opportunity to comment on Ofgem's P194 Impact Assessment and is pleased to see that Ofgem has undertaken an impact assessment in this important area.

International Power has interests in some 30GW of generation worldwide and operates approximately 5,000 MW of plant in the GB market, including the coal-fired station at Rugeley, Deeside Power CCGT, and, through a 70:30 partnership with Mitsui & Co., Ltd., Saltend Cogeneration Plant in Hull, First Hydro's pumped storage power stations at Dinorwig and Ffestiniog, plus a share in Derwent Cogeneration plant.

We agree with Ofgem's conclusion that overall the benefit of introducing this modification is positive, albeit finely balanced. However we do think the benefits of this modification are overstated and suspect that they are closer to the benefits identified by National Grid rather than in the range suggested by Ofgem.

Whilst we are dissatisfied with the continued piecemeal changes to the cashout arrangements, we do believe that a change is required to improve security of supply at times of system stress. P194 is one way of addressing this problem and it has the benefit that it can be implemented in time for next winter. P194 will also improve market liquidity, which has suffered from a combination of benign cashout prices and increased industry consolidation.

We do not believe that P194 will offer any increased potential for gaming and are disappointed that Ofgem continues to consider this a possibility when the CORWG could identify no potential examples of gaming under the current mechanism or under P194.

Economy and Efficiency

It is more efficient for a market to resolve supply and demand imbalance than a monopsony buyer. Cashout prices should therefore incentivise parties to contract in advance of gate closure, minimising the actions that must be taken by the System Operator.

For 2005, the average cost of accepted offers was around £84/MWh whereas the average PX fixing price was around £36/MWh. The disparity between these two incentivises plant to offer generation into the BM rather than selling it in the forward markets to other parties to balance their positions.

P194 will increase the SBP closer to the cost of accepted offers. Consequently, the price that parties will be willing to pay to avoid imbalance exposure will also increase. This higher price will encourage generators to sell forward rather than taking their chances of an offer being accepted in the BM.

As a result, less balancing actions will be needed in gate closure timescales. The degree to which system imbalance is resolved by the market rather than by the System Operator in the BM will improve.

In addition, the lower SSP under P194 will reduce system length when the system is long. National Grid's role as residual balancer will therefore reduce. Overall P194 will improve the economy and efficiency of balancing the system.

Security of Supply

The possibility of higher cashout prices under P194 will provide an increased incentive on generators to ensure provision of reliable plant and on suppliers to accurately predict demand. Both of these will lessen the risk of demand reduction occurring. In the longer term, the higher short term prices as noted above will feed through into the longer term prices providing better market signals to support investment.

Improved liquidity

As noted above P194 will encourage generators to trade in the short term markets rather than withholding generation for the BM. This will enhance liquidity which, as Ofgem has observed, has reduced since P194 was implemented.

Opportunities for gaming

We do not believe that the current cashout mechanism provides opportunities for gaming as there are too many uncontrollable factors to guarantee success. P194 does not increase the ability to game, in fact P194 would make accepted marginal bids and offers (and any gaming) *more* transparent to the market than at present.

Yours sincerely

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