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Dear Sonia

Preliminary views consultation – 2007/08 NGET incentives schemes

International Power is responding to the Preliminary views consultation on the 2007/08 Incentive schemes on behalf of First Hydro Company, Saltend Cogeneration Company Ltd, Rugeley Power Ltd, and Deeside Power Development Company Ltd. Our comments are restricted to discussion of the external electricity SO incentive arrangements.

As stated in our response to the open letter published by Ofgem in July, we support the reintroduction of a one-year bundled scheme from April 2007. In general, our comments below are consistent with wishing to maintain the previous framework, and avoid any unnecessary complexity. We note that Ofgem is proposing a "fundamental review" of SO incentive arrangements next year. If we can expect significant changes to result from this review then we believe it to be inappropriate to materially alter the nature of the 2007/8 scheme.

Indexation (Qs 1-3)

Indexing some/all elements of IBC to wholesale prices might have some merits but there is little detail in the consultation as to how this would work and, with reference to our comments above, at this stage we do not consider it appropriate to introduce indexing.

National Grid has concluded that the main driver of IBC is the wholesale electricity price. On examining the helpful sensitivity analysis of the various components of IBC published in the consultation document, we note that a 10% change in the wholesale price has around a 3% impact on the forecast of total IBC. National Grid considers that the other main drivers; NIV, bid/offer multipliers and free headroom are not likely to change from current levels so we have ignored the impact that a change in one these drivers would have on IBC.

Since a change in wholesale has a relatively small impact on IBC and Ofgem proposes to continue with a one year scheme, indexation over this timescale seems unnecessary. Reactive Power is the only cost that involves a direct link to energy prices. There may therefore be some merit in indexing this aspect of the external scheme.

We also have concerns that introducing a price risk band would dilute the incentive to first accurately forecast the level of IBC (and forward prices) and second to procure day to day balancing services in an efficient and economic manner. This may lead to perverse incentive being placed on National Grid. Even with a longer duration incentive scheme, it will be as difficult to set the reference price for the price band as it is to set the level of IBC adding further complexity to the incentive scheme

Finally, IAEs are in any case available as a back stop for material deviations to the level of IBC – presumably if the key driver to such deviations happens to be changes in energy prices, then it is for NG to consider making a claim.

Ancillary services (Q6)

The forecast cost for 06/07 of £293m is now looking low compared to what has already been spent. In the first 5 months, National Grid spent £136m[1] on ancillary services, scaling this up to the full year gives £326m (assuming there are not significant Ancillary services actions taken to resolve constraints). This is close to forecast 07/08 levels.

The 07/08 forecast therefore looks reasonable, although without access to some of the detailed justification provided to Ofgem by National Grid (relating for example to Standing Reserve) it is difficult to comment further.

Prospects for a reduction in forecast costs (Q7)

With the approval of BSC mod P205, P194 has been superseded. National Grid had estimated that the increase in system length because of the stronger incentives to balance under P194 would result in savings of £2m per year. With P205 now in place, we no longer expect these saving to materialise.

External constraint costs (Q9)

Scottish internal constraint costs are best managed as part of a bundled incentive due to the interrelatedness of these actions and other services.

Yours sincerely

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Manager, Market Development

[1] Taken from National Grid's Monthly Balancing Services Summary