International Power Plc
9th Floor
80 Cannon St
London
EC4N 6HL
Tel 0870 238 5558

Mark Feather
Associate Director, Industry Codes and Licensing
Ofgem
9 Millbank
London
SW1P 3GE

2 March 2007

Dear Mark

International Power response to Ofgem's Offtake Impact Assessment

This response is sent on behalf of International Power's UK CCGT generation assets. In the UK, these comprise 100% of Deeside Power Development Co Ltd, and a 70% stake in Saltend Co-generation Company Ltd in partnership with Mitsui and Co., Ltd of Japan. Worldwide, International Power is a leading independent power generation company with interests in 38 power stations in 18 countries around the world with a net generating capacity of 18GW.

International Power has already provided its views on Mod 116 and our preference to continue with the current arrangements via Ofgem's approval of Mod 116A.

The NERA report on behalf of the Gas Forums cites a net disbenefit for the mod 116V of between £113m and £78m and for mod 116 CVV, a disbenefit of between £33m and £9m. Ofgem on the other hand, views these mods as having a net benefit of £8.3m and £47.2m respectively. Taking the mid point of the NERA disbenefits, the difference between the NERA view and the Ofgem view is £68m in the case of 116CVV and £103m for 116V. We struggle to see how two impact assessments which presumably used the same cost data can be so far apart.

One of the recommendations of the recent House of Commons Committee of Public Accounts report HC110 on the Gas distribution networks sale was the need to assess the likelihood of different scenarios. The Ofgem IA frequently uses the word 'should' in assessing the benefits of the mod 116 proposals; should improve investment signals, should bring about more efficient NTS investment signals, should reduce the potential for discrimination. Despite these conditional assessments, Ofgem assigns full benefits to improvements that only might happen. Ofgem should assign probabilities to these benefits. For example, it would seem reasonable to consider the likelihood of National Grid gas discriminating between networks and /or

offtakes in the allocation of capacity and flexibility and to apply this probability to the identified benefits.

Efficient Investment Signals

Ofgem lists the incremental NTS exit capacity capex forecast in table 3.2 of its Impact Assessment and forecasts an average annual spend over 2007 to 2012 of £79.9m. In the June 2006 Impact assessment, the capex forecast was estimated to average £65m over the same period. Back in Nov 2004, the Final RIA gave a capex estimate for the period 2005 to 2012 of £12m per year. Ofgem offered no explanation in its June 06 IA of the fivefold increase and in this latest IA offers no explanation for why forecast capex has increased again by on average another £15m. Without any detailed breakdown or explanation for this 660% increase in forecast capex in just over two years the PV saving arising from more efficient investment signals due to the mod 116 variants (bar 116A) do not look credible.

A 6.5% saving has been applied to the capex forecast, made up of 3.5% from more efficient investment signals and 3% from removing the long run NTS interruption inefficiencies. We struggle to see how removing long run interruption which facilitates security of supply can be seen as efficient especially if the site decommissions its back up fuel facility. Furthermore, it is not clear how requiring a user to replace its current long run interruptible contract with a requirement to buy firm capacity, and then sell it back to NG at an as yet unknown price can be seen as offering more flexible contracting arrangements than what is available under the current arrangements.

NERA, in its December 2006 IA suggested that the 6.5% efficiency figure was subjective and Ofgem agrees in this IA that there is some uncertainty in quantifying the level of benefits. Despite this uncertainty, Ofgem continues to apply a 6.5% efficiency saving with no further justification as to why the figure continues to be appropriate.

Since the efficient investment signals make up the bulk of the quantitative benefits of introducing mod 116, Ofgem should provide a more detailed explanation of why capex forecast costs up to 2012 have increased by 660% in two years, why a 6.5% efficiency saving remains appropriate and how the removal of long run interruptible exit is more efficient. .

Non discriminatory allocation

If the current transitional arrangements give NGG the potential to favour the NG retained distribution business over the GDNs then NGG's licence should be reviewed to ensure that this risk is removed. Additional measures on top of the licence obligations are inefficient rather than offering a comparative efficiency benefit of 5% as suggested by Ofgem. With sufficiently strong licence conditions in place we do not see any cost savings will be delivered due to the non discriminatory allocation of capacity products.

Even if Mod 116 did remove the scope for discrimination between the retained and independent GDNs, it might introduce other types of discrimination within the control of NGG the costs of which have not been considered in the Ofgem IA. For example additional costs arising from discrimination from the allocation of flexible capacity, reserve prices for flat and flexible capacity and buy back prices for firm capacity have not been considered.

Reduced incidence of ARCAs

The costs ascribed to the reduced incidence of ARCAs seem excessive. The relevant costs that should be assessed for the negotiation of disputed ARCAs are the incremental costs. For Ofgem at the very least we would not expect its costs to be £300k per ARCA as this implies that at least 3 full time people are employed in addition to current staffing levels to negotiate the disputed ARCA. NGG must also have experience of the ARCA disputes process so again only the incremental cost should be applied. The use of incremental costs would be consistent with the cost data that respondents to the Enduring Offtake cost survey pro forma were asked to provide. Without on hand knowledge, some NTS users (but not all) might incur costs of £300k per dispute especially if consultants are used. We therefore believe that as a maximum the PV cost saving would be a no more than a third of the £9.7m PV cost quoted by Ofgem.

Setting aside the above, we agree with the AEP's comments that absent reform we now have two determinations that state that only one year's NTS exit capacity charges is required as an ARCA commitment for CCGT connections. Going forward it would be very difficult for NGG to require any greater commitment unless it could demonstrate that a particular CCGT was more risky than those that had preceded it. Absent reform we consider further determinations for CCGT connections to be unlikely and therefore there would be no PV cost saving associated with the reduced incidence of ARCAs.

Yours sincerely,

Libby Glazebrook
Manager, Market Development