



*Promoting choice and
value to customers*

Your Ref:
Our Ref:
Direct Dial: 020 7901 7412
Email: sonia.brown@ofgem.gov.uk

cc: All interested parties

06 January 2006

Dear Colleague,

National Grid Electricity Transmission System Operator Incentives 2006-07 – Revised Forecast

On 22 December Ofgem published an initial proposals letter in respect of National Grid Electricity Transmission's (NGET) System Operator (SO) incentive scheme, which invited views in respect of NGET's initial forecast of its SO costs for 2006/07¹. As noted in that letter, shortly prior to Ofgem's publication, NGET wrote to Ofgem stating that it wished to withdraw its forecast level of external balancing costs for 2006/07 citing concerns over increases in the costs of managing constraints on its system and high and volatile wholesale prices. NGET indicated that it would submit a revised forecast of its external incentivised balancing costs for 2006/07 to Ofgem in early January. In accordance with its request, NGET has provided us with the following revised forecast:

- ◆ £451.4² million for its external balancing costs for 2006/07

A detailed paper explaining NGET's revised forecast and a cover note explaining differences to its initial forecast are attached in Appendices 1 and 2 of this letter.

For the purpose of clarification, publication of NGET's revised forecast should not be viewed as changing Ofgem's initial views in respect of NGET's external balancing costs. As set out in our initial proposals document, Ofgem made clear to NGET that it could not see any justification for revising the existing forecasts. NGET's forecasts are based on a range of scenarios, including extreme price (and constraint costs) scenarios. Ofgem's view was that no new information had come to light that would justify changing the forecasts. The risks of constraint costs being higher than expected and of high and volatile gas and electricity prices have been known for some time and in our view are captured in the existing forecasts.

¹ "National Grid Electricity Transmission System Operator incentives 2006-07", Ofgem, 22 December 2005. This letter can be found on Ofgem's website (www.ofgem.gov.uk) under Areas of Work > Wholesale Markets.

² 2006/07 prices.

Views invited

Ofgem's initial proposals document invited views on NGET's initial forecasts. We continue to invite views on the areas specified in our initial proposals letter and on other areas that are likely to affect NGET's projected costs as identified in that letter. In addition, we would now like to invite views on NGET's revised forecasts for its external SO balancing costs for 2006/07 as noted above.

In order that all views can be considered as part of this process, Ofgem would continue to ask that all responses (i.e. views on both NGET's initial forecasts and on its revised forecast), are submitted to Ofgem by **2 February 2006** either electronically to wholesale.markets@ofgem.gov.uk or by post addressed to:³

Sonia Brown
Director, Markets
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Following consideration of responses, Ofgem expects to publish its final proposals in February 2005 including a statutory notice of Ofgem's intention to modify NGET's transmission licence under section 11 of the Electricity Act 1989 in relation to the proposals contained therein.

If you wish to discuss any aspect of this document, please contact Kevin James (020 7901 7181) or David Cox (020 7901 7390) who will be pleased to help.

Yours sincerely,

Sonia Brown
Director, Wholesale Markets

³ All responses will normally be published on the Ofgem website and held electronically in the Research and Information Centre unless there are good reasons why they must remain confidential. Respondents to the consultation should try to put any confidential material in appendices to their responses. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.