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Dear Steve,

NGET's External System Operator incentive scheme 2005/06:

Submission of Notices under Special Condition AA5A Part 2(i), paragraph 11 of National Grid Electricity Transmission plc's Transmission Licence in respect of Scottish Constraints and CAP047

In setting the scheme target within Ofgem's Final Proposals¹ document for the above incentive scheme, the following specific allowances were made for the costs associated with:

- £20m allowance for constraints across the Cheviot boundary
- £10m allowance for constraints within Scotland (Internal Scotland constraints)
- £7.35m allowance for the costs associated with CUSC Amendment Proposal 047 (CAP047)

In the Final Proposals, Ofgem highlighted that the Income Adjusting Event (IAE) provisions would be available in the event that there were any material deviations (assessed against the materiality threshold of £2 million), net of countervailing factors, above or below these baseline allowances in these areas. Therefore, if incremental costs were materially above or below Ofgem's baseline assumptions, net of countervailing factors, NGET (or any other BSC Party) may raise an IAE in order to seek an income adjustment.

These arrangements were confirmed in your letter to me of 9 March 2005 'NGC's 2005/06 Great Britain System Operator incentive scheme'.

¹ 'NGC System Operator incentive scheme from April 2005, Final proposals and statutory licence consultation', Ofgem, March 2005

In NGET's opinion, annual Incentivised Balancing Costs (IBC) for the scheme period, 1st April 2005 to 31st March 2006, have been increased as a result of Cheviot boundary constraints, Internal Scotland constraints and CAP047 implementation. NGET has calculated the incremental costs above Ofgem's baseline assumptions for these three areas.

These calculations are contained in the attached notices for Scottish Constraints (covering Cheviot and Internal Scotland costs) and CAP047. The calculated costs detailed within these two notices are as follows:

Scottish Constraints:

	Total Cost (£m)	Scheme Allowance (£m)	Net IAE Amount (£m)
Internal Scotland	£ 28.54	£ 10.00	£ 18.54
Cheviot	£ 31.63	£ 20.00	£ 11.63
Total	£ 60.18	£ 30.00	£ 30.18

CAP047:

	Total Cost (£m)	Scheme Allowance (£m)	Net IAE Amount (£m)
Total	£ 12.94	£ 7.35	£ 5.59

Each of the two attached notices provides full detail of:

- The Incentivised Balancing costs associated with each of three areas of cost (Cheviot, Internal Scotland and CAP047) and the net change in IBC between the scheme allowance and outturn costs;
- The methodology used to calculate the Incentivised Balancing Costs associated with each of the three areas of cost;
- Actions taken by NGET based on the information available at the time to efficiently and economically manage the costs associated with each of the three areas of cost

As such, this letter and the two documents attached:

- Constitute two notices to the Authority under Special Condition AA5A Part 2(i) paragraph of NGET's Transmission Licence that, in NGET's opinion, income adjusting events have occurred in relation to the year 2005/06
- Establish that the net change in IBC between the scheme allowances and outturn costs as a result of the income adjustments have been calculated at £5.59m for CAP047, £18.54m for Internal Scotland and £11.63m for Cheviot costs.
- Request the Authority to approve the income adjusting events and determine that the amounts of income adjustment be set to £5.59m in respect of CAP047 and £30.18m in respect of Scottish Constraints (the aggregate of Cheviot and Internal Scotland), a total of £35.77m across the two IAE notices.

If approved by the Authority, the IAE mechanism (RT_t) will reduce the calculated level of Incentivised Balancing Costs (IBC) by the allowed IAE amounts. Based on the current reconciliation data, approval of all proposed IAE amounts would reduce IBC for 2005/06 from £427.2m to £391.5m, compared to a scheme target IBC of £377.5m.

In the interests of transparency and in view of Ofgem's desire to consult openly on these costs we have endeavoured to provide a full explanation of these costs within the two notices attached in accordance with the requirements of NGET's transmission licence. In doing so we have tried to keep as much information as possible in the public domain; that information which we request is kept confidential to Ofgem for commercial reasons has been placed in confidential appendices such that the remainder of the document can be published as a whole if required.

Whilst there is significant detail in the attached notices we would be happy to provide further information, background material and analysis in support of the attached notices.

If you would like to discuss any of the information contained within the notices further, please feel free to get in touch with me or Chris Bennett.

Yours sincerely,

[by email]

Tim Tutton

cc Sonia Brown