

To:
Generators, Shippers, Suppliers, Customers,
Transmission and Transportation System Owners and
other Interested Parties

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Dear Colleague,

**National Grid Electricity Transmission and National Grid Gas System Operator
Review Initial Proposals Process - Proposed Next Steps**

Background

On 1 November 2007 Ofgem published an open letterⁱ detailing the next steps in its System Operator Review. In the letter Ofgem outlined the process for the development of incentive schemes to apply from 1 April 2008:

- Ofgem has decided to experiment with an alternative process that will mean National Grid takes the lead to provide and consult on its own set of incentive scheme Initial proposals;
- Ofgem considers that National Grid should be better placed to present the real choices and trade offs that we have to make to operate the transmission systems efficiently, translating these into different incentive options for customers to debate and consider with us;
- In taking the lead in this process, National Grid should aim to present customers with meaningful choices in terms of the share of risk and reward borne by customers and National Grid;
- Ofgem will review the success of this new process in preparing Final Proposals for schemes to apply from 1 April 2008 in February.

By facilitating this process, Ofgem is looking for National Grid to engage with its customers to better understand their priorities when developing proposals. In turn Ofgem is looking for engagement by interested parties in the process which, if successful, should deliver new insights and identify customer and National Grid preferences for the new incentives to apply from 1 April 2008.

We fully support Ofgem's move to this new approach and as our first step in leading the process we are keen to ensure that interested parties have the opportunity to understand and comment on the process we intend to follow.

Proposed Process

The outline timeframe for the process is already established by Ofgem's previous consultation process, as described in its previous consultation documents and letters. Ofgem has requested that we publish our initial proposals consultation in early December, for a seven week consultation period. This is to allow time for Ofgem to develop and consult on Final Proposals with interested parties in February and March 2008.

In undertaking to lead this process, we are very conscious that the key to ensuring participants can fully contribute to the process will be:

- the provision of relevant information by us into the process; and
- the opportunity to discuss the scheme proposals and the costs of operating the system with us and other interested parties.

As the first part in this process, we would invite parties to respond to this letter with their views as to the specific information and fora that will best meet their needs and assist in their full engagement in the process. Our initial outline for the key steps and events in the process is as follows:

Early December 2007	Initial Proposals Consultation published
December 2007	Presentation at Operational Forum (Gas & Electricity)
December 2007- January 2008	Demand Side Working Group and bilateral meetings
Early January 2008	Initial Proposals Workshop
Mid January 2008	Consultation closes

In addition to the information in the consultation document, the above process would allow for additional opportunities for face to face presentation, discussion, questions, explanation and debate at:

- Operational Fora
- Initial Proposals workshop
- Other relevant industry meetings
- Bilateral Meetings

In proposing this framework we want to ensure that we provide the opportunity for as many parties as possible, representing all parts of the industry, to engage in the process. We would invite parties to identify any further opportunities to achieve this objective. We would also like to offer the opportunity for bilateral meetings to interested parties who

would like to discuss aspects of the proposals in more detail. Subject to demand, we hope to be able to meet all requests for these.

You can also register your interest in receiving future communications on the Initial Proposals consultation from us by emailing us at SOIncentives@uk.ngrid.com.

Scope

In developing initial proposals for the December document, National Grid will build on contributions from Ofgem and interested parties during the process so far and, in particular, Ofgem's expectations as set out in its 1 November letter. In establishing this process, Ofgem highlighted that it expects schemes from 1 April 2008 to apply for only one year unless National Grid comes forward with more enduring scheme proposals. National Grid does not anticipate proposing anything other than one year schemes for the Electricity SO. However, due to the different structure of the Gas SO schemes, and a history of longer term incentives, we do anticipate being able to propose multi-year schemes for some Gas SO schemes in early December.

Summary

I would like to reiterate our commitment to ensuring we fully engage with you and other interested parties as part of this new process for SO schemes from 1 April 2008. We hope that our initial process outline above forms a good foundation for this and we would welcome your views both on this proposed process and on the type of information that will best meet your needs.

If you would like to discuss any aspect of this letter or the wider review please do not hesitate to get in contact with myself or use one of the options below to contact us or register your interest.

Yours sincerely,

Chris Bennett
Regulatory Frameworks Manager
National Grid

ⁱ National Grid Electricity Transmission and National Grid Gas System Operator Review - Next Steps, Ofgem open letter, 1 November 2007,
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=116&refer=Markets/WhlMkts/EffSystemOps/SystOpIncent>

Contact us:

To register your interest in receiving future communications on this consultation process please email: SOIncentives@uk.ngrid.com

On the web:

New dedicated web pages for this process will be available shortly under the 'SO Incentives' tab at the following addresses:

Electricity SO Incentives: <http://www.nationalgrid.com/uk/Electricity/>

Gas SO Incentives: <http://www.nationalgrid.com/uk/gas/>

Talk to us:

Gas

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