



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

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*Promoting choice and  
value for all customers*

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Date: 7 December 2007

Dear Colleague

### **National Grid Electricity Transmission and National Grid Gas System Operator External Incentive Schemes to apply from 1 April 2008 – Initial Proposals**

On 1 November 2007, I announced that we have decided this year to experiment with a different process in developing the incentive schemes to apply from 1 April 2008 in respect of the National Grid Electricity Transmission (NGET) and National Grid Gas (NGG) System Operator (SO) External Costs. I outlined that in previous years National Grid has provided its forecasts for the costs that it will incur in its roles as gas and electricity SO. Ofgem has then scrutinised these forecasts and published its Initial Proposals for the options for incentive schemes based on the information provided to it by National Grid. Based on the responses received to this consultation, Ofgem has then produced Final Proposals (including licence modifications) by the end of February, for implementation on 1 April.

This year, instead of Ofgem taking the lead at the Initial Proposals stage, we requested that National Grid provide and consult upon its own set of proposals. Today National Grid has published its Initial Proposals in respect of the incentive schemes to apply from 1 April 2008.<sup>1</sup>

In the development of these proposals, Ofgem has encouraged National Grid to consider how it can present its customers with meaningful choices in terms of the sharing of risks and rewards between Grid and customers and to reflect this in the incentive scheme structures that it proposes. We would like to take this opportunity to encourage both National Grid and interested parties to debate and discuss the proposals tabled by National Grid during the consultation period<sup>2</sup> set out by National Grid.

However, for the avoidance of doubt, Ofgem has not reviewed or approved these proposals. All the projections, forecasts and proposed incentive structures are the work of National Grid.

Following the consultation process, Ofgem will take into account the results of the consultation in deciding upon the Final Proposals to be put forward. If the new process has gone well, we may be better placed than in previous years to implement proposals that represent a good deal for National Grid and for customers. If we consider that the proposals that National Grid has tabled do not represent the best deal for customers,

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<sup>1</sup> "National Grid System Operator Incentives, Initial Proposals Consultation", National Grid, available from the National Grid website, <http://www.nationalgrid.com/uk/Electricity/SolnIncentive>. Responses to the consultation should be made to National Grid. Grid will publish these responses and forward them on to Ofgem for its consideration.

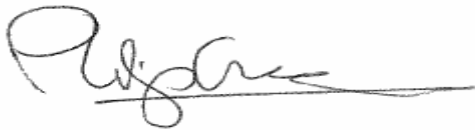
<sup>2</sup> As set out in National Grid's Initial Proposals document, the closing date for the consultation is 25 January 2008.

Ofgem may choose to implement a different scheme to that proposed by National Grid<sup>3</sup>. Ofgem will take the options tabled by National Grid into account when deciding on its Final Proposals.

I would also like to take this opportunity to provide you with an update on the Long Term SO Review. At the workshop that we held on 1 November, we noted that there was little support for Ofgem giving priority to work to establish a long term system operator incentive scheme. Many of these concerns related to the difficulty of establishing a long term regime whilst managing simultaneously other likely changes in the regulatory framework that will also have an impact on the system operator's costs and incentives. We recognise these concerns. We will not therefore in the short term be starting additional work to prepare a long term scheme. However, we note that other factors such as work connected to achieving the 2020 renewables targets, the review of transmission access and the cash-out review may require Ofgem, National Grid and industry participants to revisit longer term system operator issues sooner. We welcome any further discussion on these issues and expect to return to them in due course.

Should you wish to discuss any element of National Grid's Initial Proposals with Ofgem, please do not hesitate to contact me or alternatively, Matthew Buffey ([matthew.buffey@ofgem.gov.uk](mailto:matthew.buffey@ofgem.gov.uk), 020 7901 7088).

Yours sincerely



Philip Davies  
Director, GB Markets

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<sup>3</sup> National Grid must consent to any proposed licence modifications before they can be implemented. If National Grid chooses not to consent to any licence modifications proposed by Ofgem as part of this process Ofgem may refer the matter to the Competition Commission.