



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

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value for all customers*

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Dear Colleague

National Grid Electricity Transmission System Operator Incentives from 1 April 2010

On 11 March 2010 Ofgem published its Final Proposals Consultation in respect of National Grid Electricity Transmission ("NGET") System Operator ("SO") incentive schemes to apply from 1 April 2010.¹ This consultation closed on 12 April 2010 and we received responses from five industry participants.² On 25 March 2010, NGET consented to the licence modifications proposed.

I would like to take this opportunity to thank those who responded to the Final Proposals Consultation and also to those who participated more widely in the development of the SO incentive schemes from 1 April 2010. We have considered the responses to the Final Proposals Consultation and taking those into account we believe it remains appropriate to direct the licence modifications to be made in line with those proposed. We have today issued the relevant direction.

A number of detailed points were raised in the responses. Our responses are set out below.

One respondent objected to the application of the incentive scheme retrospectively from 1 April 2010. We appreciate that the retrospective application of the incentive scheme is not ideal. However, on the basis that NGET were aware of the proposal prior to 1 April 2010 and consented to the proposed licence modification, we therefore expect NGET to have already acted in light of the proposed incentive scheme. In addition, the retrospective application of the incentive scheme covers a period of only two weeks.

We note that one respondent would welcome more transparency of the adjusters agreed between NGET and Ofgem. The same respondent also queried whether the material change could be agreed prior to the commencement of the scheme year. We have today published the adjuster letters between Ofgem and NGET, which illustrates that the relevant material changes were agreed on 30 March 2010 which would be applicable if the licence modification were directed.

¹ "National Grid Electricity Transmission System Operator Incentives", Ofgem Consultation Document, ref 33/10, March 2010: www.ofgem.gov.uk

² Responses were received from Centrica, SSE, IP, EDF, and NGET. These are available on Ofgem's website: www.ofgem.gov.uk

Multi-Year Scheme and the Review of NGET's forecasting methodology

Respondents welcomed the new licence condition which requires NGET to cooperate with the Authority in undertaking a review of the methodology for developing its forecast.

With regard to a multi-year scheme, three respondents supported the development of a multi-year scheme, whilst one respondent welcomed the move to multi-year schemes but was concerned that there may be obstacles to producing a robust multi-year scheme. One respondent remained unconvinced by the benefits of moving to a multi-year SO incentives scheme.

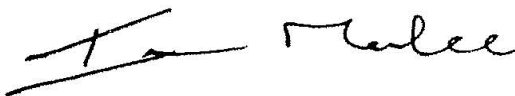
We continue to consider, as per our May 2009 Open Letter, that continuing to develop annual incentive schemes is sub-optimal as such arrangements do not incentivise NGET to take a longer term view of its SO costs. We consider that a return to longer term incentives would be advantageous in terms of encouraging longer term action, increasing information transparency and reducing administrative burden, all of which would ultimately be in the interests of consumers. We also consider that there may be benefit in developing SO and Transmission Operator (TO) incentives along the same timeframes.

On more detailed points, one respondent noted that alternative methods should be investigated in preference to multi-year scheme. In addition, two respondents were concerned with NGET's current forecasting methodology. One respondent went on to suggest that an Information Quality Incentive (IOI) and/or an Economic Purchasing Obligation (EPO) might mitigate the problem. In addition, one respondent was concerned with the reluctance on NGET's part to contract for services ahead of agreement of the scheme.

In response to the comments made, we will look to address such issues in the review. We welcome industry's support and interest in being involved and we will be considering how best to involve industry participants. In the meantime if you would like to meet with Ofgem please contact Giuseppina Squicciarini.

Should you wish to discuss any aspect of the SO incentive schemes please contact Giuseppina Squicciarini (Giuseppina.Squicciarini@ofgem.gov.uk).

Yours sincerely



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