

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

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Dear Colleague,

National Grid System Operator Incentives from April 2010

On 28 May 2009 Ofgem published an open letter¹ setting out its views on the objectives, process and timetable for the development of the SO incentive schemes to be in place from April 2010.

National Grid supports the further development of the incentive scheme in line with the objectives set out in Ofgem's letter, and has put together an incentive development process designed to fully meet these objectives and the proposed timetable. In doing so, we have also taken into account industry feedback that we have received and will be bringing forward to publication date of our Initial Proposals in comparison to previous years.

The purpose of this letter is to share with the industry our proposed timetable and invite all interested parties to participate in the development of appropriate SO incentive schemes.

Below we outline our proposed process and timetable for meeting these objectives.

Proposed Process and Timescales

As in recent years, National Grid will be leading on the development of the Initial Proposals for SO incentives and we will again be publishing a number of "mini" consultations to address specific key issues surrounding the development of multi-year schemes, and the potential for bundled / unbundled schemes. Throughout the process we also intend to engage with the industry to seek views and feedback on our proposals.

¹<http://www.ofgem.gov.uk/Markets/WhlMkts/EffSystemOps/SystOpIncent/Documents1/Open%20Letter%20final.pdf>

Below is a high level outline of the proposed timetable.

Process Milestone	Proposed Date
Initial industry engagement	June/July 2009
Publication of mini consultation documents	July/August 2009
Publication of Initial Proposals	October 2009
Industry event / workshop	November 2009
Ofgem to provide initial comments	November 2009
Initial Proposals consultation period closes	December 2009
Ofgem consultation on Final Proposals	Early 2010
Scheme go live	April 2010

There are a number of key issues that need to be addressed in order to develop robust Initial Proposals, and as noted above, we intend to break down these issues by publishing a number of mini consultations. Your responses to these mini consultations will feed directly into the development of our Initial Proposals.

For electricity, we intend to release three such consultations:

Document	Mini consultation topics
1	Reactive power, transmission losses and black start
2	Energy (e.g. Reserve and Response)
3	Constraints

The consultations have been split in this way as we believe these topics are to a significant extent standalone and they will benefit from separate consideration. Within each of the mini consultations, we will focus on the reasons for whether it would be appropriate to unbundle the specific components, if there are appropriate external measures to use for indexation and the suitability for multi year schemes.

For gas, we also intend to release three consultations:

Document	Mini consultation topics
1	Residual Balancing, Demand Forecasting, Maintenance, Data Publication, System Flexibility, CV Shrinkage, Information on Incentives, bundled vs unbundled schemes
2	Environmental Incentives
3	Operating Margins

Additional mini consultation documents may be issued should the need for arise. One example of this might be where further consultations on any potential new incentives are required.

Industry Engagement

In its letter, Ofgem recognises the valuable contribution made by the industry in developing the incentive schemes implemented in April 2009 and notes that it is keen to further promote engagement from industry participants, end customers and smaller

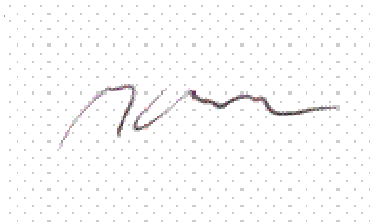
suppliers in this year's process. In response, National Grid has already presented at a number of industry meetings and arranged bilateral discussions with interested parties to highlight the issues for this year's consultation. We will continue to present regular updates and facilitate debate at relevant forums and in November 2009 will be hosting an industry event for gas and electricity to present our initial proposals in detail. If you would like National Grid to present at any future meeting, or you would like to meet on a one to one basis to discuss this year's consultation, then please contact us using the contact details at the end of this letter.

Summary

National Grid has successfully led on the development of the last two annual SO incentives and looks forward to leading on the development of Initial Proposals leading ultimately to the implementation of Final Proposals with effect from April 2010.

We are committed to ensuring we fully engage with all interested parties, and believe that the process outlined in this letter forms a good foundation for this, but 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 development of SO incentives, please do not hesitate to contact either myself, John Perkins or Malcolm Arthur, whose details are listed below.

A handwritten signature in black ink, appearing to read 'Mark Ripley', is centered within a rectangular area filled with a light grey dot grid pattern.

Mark Ripley
Regulatory Frameworks Manager
National Grid

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 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

John Perkins Tel: 01926 656337 john.perkins@uk.ngrid.com

Electricity

Malcolm Arthur Tel: 01926 654909 malcolm.arthur@uk.ngrid.com

General enquiries: SOincentives@uk.ngrid.com