

Mr. John Perkins
National Grid plc
National Grid House
Gallows Hill
WARWICK
CV34 6DA

28 August 2009

RE: **GAS SO INCENTIVE PROPOSALS FROM APRIL 2010**

Dear John,

Centrica welcomes the opportunity to comment on the issues raised in consultation document 1 on the Gas System Operator Incentives for April 2010. This response is on behalf of the Centrica Group excluding Centrica Storage Ltd. There is no confidential information contained within this response. We also attempt to answer the questions posed in the consultation document.

Question 2.1	Would you support bundling some or all of the shallow SO incentives? If so please explain which schemes should be bundled, what an appropriate performance measure would be and what benefits this would deliver?
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Centrica believes that all of the shallow SO incentives should remain unbundled. The current arrangements should be continued as this makes it easier to pick out the key areas for further work and seeking improvements in performance e.g. finding the appropriate balance between driving minimal residual balancing and correct allocation of costs.

Question 2.2	Would you propose unbundling of any of the existing SO incentive schemes? If so please explain the benefits that you believe would be achieved from this.
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Centrica is unsure whether there would be any value from further unbundling of the existing SO incentive schemes.

Question 3.1	Given the review of the residual balancing scheme carried out last year, do you support our view that another review of the incentive structure is not required this year?
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Centrica does not believe that last year's review was as fundamental as National Grid claims. Until there has been experience of operation with a much weaker or zero linepack measure there continues to be a need for annual review. There is also a need for a more fundamental review of all residual balancing incentives, including the relationship with UAG, default system marginal prices and nomination/scheduling incentives. The information which is shown in the consultation document and limited detail subsequently published suggests that the objectives of the changes, which were to reduce the level of residual balancing trades and bring the times of these trades earlier in the gas day, have not been met.

In paragraph 45 of the consultation there is an ambiguous reference to whether the retention of the -£30k per day collar on the linepack measure is appropriate. One interpretation is that the collar should be removed and the loss for National Grid should continue to increase as the

linepack difference increases, the other interpretation is that the collar should apply at a lower level of linepack difference. Centrica believes that National Grid should be given freedom to decide whether or not a balancing action is required rather than automatically taking action under the 'polluter pays' principle, it can only be seen after the day whether a balancing action should have been taken. We would prefer to see the linepack incentive removed altogether rather than changing the collar to another arbitrary value.

Question 3.2	Do you have any views/evidence that further refinement of the residual balancing scheme parameters is required?
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Centrica believes that the increase in residual balancing activity since April 2009 and the times of day at which the activity has taken place are evidence that further refinement of the residual balancing scheme parameters is required. Further information on this is required. The price incentive should already be encouraging National Grid to act earlier in the gas day but the overall scheme should be re-designed in order to reinforce this and at the same time encourage shippers to give appropriate nominations.

Question 3.3	Are there any barriers to implementing a residual balancing scheme for more than one year?
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In theory once an appropriate residual balancing scheme has been established it should be possible to implement this for more than one year. We do not yet believe that an appropriate residual balancing scheme has been established, see the answers to questions 3.1 & 3.2.

Question 4.1	If National Grid was able to improve its demand forecasts, how would this impact on your business?
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The impact is on efficient use of scarce resources, such as peak shaving or other storage gas. A demand forecast which is too high may result in too much gas being nominated at the start of the gas day, the system is long as a result but by the end of the gas day the nominations for both this gas and normal beach gas may have been reduced and normal beach gas could have been used to satisfy demand for the whole day. The reverse could apply if the demand forecast is too low. We also believe that there should be a benefit to National Grid in system operation e.g. efficient use of compressors, from stability of input nominations and gas flows.

Question 4.2	What value (or relative value) do you place on each of the demand forecasts?
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We place highest value on the 13:00 D-1 forecast. Our observation is that the accuracy of later forecasts improves in a fairly predictable manner.

Question 4.3	Which of the forecast times do you believe should be incentivised?
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The 13:00 D-1 forecast is the only one which should be incentivised.

Question 4.4	Should consideration be given to the introduction of an additional incentive around any particular element of the forecast?
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Centrica suggests that the only element of de-composition which might be considered would be into GB (or UK) and export demand forecasts rather than using a different time element, which is likely to be highly correlated with the 13:00 D-1 performance.

Question 4.5	Should the structure of the Demand Forecasting incentive be reviewed?
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Centrica believes that the structure of the Demand Forecasting incentive is possibly balanced too much in favour of National Grid. This question raises the whole issue of how SO incentives should work in practice, see the answer to question 8.1. In the case of Demand Forecasting there is no cap, possibly for the good reason that 'perfect' performance sets a natural cap which is unattainable. Centrica would suggest that the payment of £2.1m to National Grid for 2.65% absolute error in [UK] demand forecasts, which is what would result from the 2009/10 scheme, is too high given our answer to question 4.1. The key to this is that the slope of the reward in the range of 0.15% either side of the target is currently worth 3p/therm to National Grid (average daily demand is about 100mth so a 0.15% improvement represents 150,000 therms per day or about 55mth per year and rewards National Grid with £1.6m)

Given that the true target should probably be somewhere in the range 2.5% to 3% and perhaps ideally 2.75% or 2.8% we would suggest that a payment of about £1.6m would be more appropriate either as a cap or used to reward a performance of 2.5%. This could be achieved either by reducing the target to 2.8% and reducing the slope of the reward such that a 0.3% variation from target produced £1.6m (i.e. about 1.5 p/therm) or by a more complicated set of adjustments to the parameters of the scheme.

Question 4.6	What are the barriers to a multi year incentive? How should the target for a multiple year scheme be set?
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The barriers to a multi-year scheme are that it not clear that the parameters of the current scheme are appropriate. Ideally a multiple year scheme should have the same target for each year or else, as in this case, there would need to be an expectation of continuous improvement built in, moving from the current 3% target and 3p/therm reward to 2.8% target and 1.5p/therm reward over a small number of years.

Question 5.1	What value do users put on the data items that are published under this incentive?
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Users value this data highly.

Question 5.2	Are the current levels of website availability and timeliness of data publication appropriate?
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Yes.

Question 5.3	Does the incentive value of +/- £100,000 accurately reflect the value to users of having this data available and published in a timely manner?
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The incentive value should, and does, represent the appropriate balance between the cost to the system operator of this behaviour and the benefit to both users and the system operator from making the data available.

Question 5.4	Are there any barriers to implementing an incentive scheme for longer than one year?
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In this case, no.

Question 5.5	What information, if any, do users believe should be incentivised beyond the existing defined dataset?
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The system operator should be acting in the interests of transparency and market efficiency without incentives of this kind.

Question 6.1	Does National Grid's summary (in section 6.2) accurately capture the issues with the existing maintenance planning process?
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As far as we can tell National Grid seems to have accurately captured the issues raised, these appear to fall into two categories, firstly co-ordination of site and National Grid maintenance and secondly the need for National Grid to notify a longer period of maintenance than may actually be required.

Question 6.2	Why would a change to the existing maintenance process be of value to you?
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Provided that there is willingness for all parties to communicate with each other there does not seem to be value to us in changing the current arrangements or using an SO incentive in order to encourage a change in behaviour by National Grid.

Question 6.3	What behaviour change by National Grid would be required to deliver this value to you?
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See the answer to question 6.2 above.

Question 6.4	Do you believe an incentive of maintenance planning is required? If so what would be the objective of incentive?
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We do not believe that an SO incentive on maintenance planning is required and are unclear what the objective of such an incentive would or should be. Further we believe that there are already sufficient incentives acting on National Grid with regard to maintenance planning. We are concerned that any SO incentive would restrict the freedom which National Grid currently enjoys to change maintenance plans when this is appropriate and recognise that at times this is in response to reasonable requests from shippers.

Question 6.5	Do you have any suggestions for a suitable incentive scheme?
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We do not believe that any of the incentives suggested in paragraph 97 have enough merit to be used. At the present time the only suggestions we could offer would be

- An SO incentive in the form of a financial penalty for days of NG unavailability (which are not properly notified) is likely to result in a payment to NG by shippers anyway and in cases where it is cheaper for NG to incur a penalty this might have a greater impact on shippers than the current system e.g. NG knows that a job is behind schedule but instead of having all jobs behind schedule leaves first one unfinished and moves on to others
- A financial penalty for days of NG availability (which were previously notified as unavailable) is likely to result maintenance being 'extended' to fill the whole period previously notified as unavailable

Question 6.6	Could improvements be made to the existing communication process or UNC maintenance provisions?
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Centrica was not one of the shippers that suggested giving consideration to developing a new incentive around maintenance planning and the UNC rules seem to be satisfactory in this respect.

The best form of maintenance notice might be 'NG requires x out of y days' and the shipper can take commercial decisions based on this, such as if x is small compared with y then plan to generate but buy from the market at short notice on the actual maintenance days or if x is close to y then plan not to generate but know that there may be days when power can be sold to the market at short notice or the plant can be on standby.

Question 6.7	Are there any specific data items that National Grid should start recording that would help facilitate the debate on a maintenance incentive?
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It might be useful to record the number of instances when changes to maintenance dates are requested, who made the request and whether or not the request is agreed to.

Question 7.1	Have the key areas where further information on incentives is required been correctly captured?
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Yes.

Question 7.2	Are further refinements required to the summary of the incentive schemes (contained in Appendix 1) prior to its publication?
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No.

Question 7.3	Would publication of the proposed graphs showing how performance to date of incentive schemes relates to end of year incentive payments be helpful?
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Yes, but having the actual numbers available is more important than graphs.

Question 7.4	Is there other information that could be used to better indicate likely end of year incentive payments?
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Yes. We would like to see publication of the daily values which were given as part of last year's consultation process continued on an ongoing basis. Specifically this refers to

- Details of first and last balancing actions
- Unaccounted for gas
- Compressor fuel usage
- Shrinkage volume

All data should be published within 2 months of the end of the quarter.

Question 7.5	Would publishing a standing item on the link between incentive revenues and the SO commodity charge be helpful? Is there any additional information required prior to publication?
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Yes. More transparency is needed in this area. The move from Mod 698 to Mod 186 has lost some forecast information. As an example, we would like to understand more about the causes of variation in SOOIRCt – how much is due to variations in each of gas costs, system flows and expected incentive performance.

Question 8.1	Would you like to make any other comments on SO Incentives that have not been captured through the other questions in this document?
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The desired behaviours have not been properly debated or reviewed. In general the target should represent an appropriate and reasonable level of performance which shippers expect from a system operator given the balance of risk and reward implied by the price control. If the system operator adds value by performing above expectation then a share of that value should be given to the system operator, possibly subject to a cap. Similarly if the performance of the system operator is below expectation and this reduces the value obtained by the shippers then the system operator should be exposed to a share of the reduction in benefit, possibly subject to a collar. The cap and collar should represent limits which are required in case either the target has been set inappropriately or cannot possibly be met because of unforeseen circumstances. Centrica continues to believe that the SO Incentives should be benchmarked against the following criteria:

1. **DO THEY INCENTIVISE IMPROVED OPERATIONAL EFFICIENCY?** The incentives should promote efficient use of both system assets (e.g. compressors) and shippers' resources.
2. **DO THEY SEEK TO MINIMISE OPERATIONAL COSTS?** Reducing the costs of operating the system should be to the benefit of all stakeholders, who should share the benefits.
3. **DO THEY CONSIDER UNINTENDED CONSEQUENCES?** This may be important to consider in the context of residual balancing and system flexibility incentives.
4. **DO THEY PROMOTE CONTINUOUS IMPROVEMENT?** Most incentives should have an element of continuous improvement built in, data publication may be a counter-example.
5. **DO THEY ENSURE AN APPROPRIATE BALANCE BETWEEN SO AND USER INCENTIVES?** With system balancing it is as important for shippers to be given the correct signals as for National Grid to achieve a target linepack movement.

6. DO THEY ACHIEVE AN ACCEPTABLE LEVEL OF UAG? Un-accounted for gas remains an issue of concern for us and we would like to see evidence of real long-term progress.

These are issues which we have commented on at length previously.

Question 8.2	Are there other areas where you believe there would be benefit from introducing a new SO Incentive?
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Yes, we believe that there would be benefit from introducing a new SO incentive regarding the use of linepack and system flexibility.

Please do not hesitate to contact me should you require further information about any of these responses.

Regards,

Clive Woodland
Planning & Analysis Manager