

**Legal & Regulatory**

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2<sup>nd</sup> August 2013

Dear James,

**Open Letter on Proposed Income Adjusting Events submitted by National Grid Electricity Transmission in relation to the 2011-13 Electricity System Operator Incentive Scheme**

1. Thank you for the opportunity to respond to Ofgem's open letter regarding National Grids Income Adjusting Events submissions. This is a non confidential response on behalf of the Centrica Group, excluding Centrica Storage.
2. We do not believe that National Grid should be permitted any of the Income Adjusting Events it has applied for. In the interests of regulatory certainty, from the perspective of customers and other users of the system, and to preserve the integrity of this and other incentive schemes, it is important that Ofgem is firm in resisting these arguments. This scheme was largely of National Grid's design and accepted by National Grid. National Grid were better placed than anyone to understand the risks involved and the outturn of costs is not particularly out of the ordinary, as System Operator costs are typically volatile and unpredictable. The scheme was indeed designed to offer protection to Grid and customers, with sharing factors and a cap/collar.
3. We are extremely worried at a growing trend of networks attempting to restate incentive performance when they find themselves in a penalty position, with the Electricity Distribution DPCR4 Losses Incentive being a particularly good example. If networks are consistently allowed to argue their way out of penalties it becomes unclear the benefits such schemes bring to users, and potentially challenges the ongoing use of such schemes. If it becomes apparent that incentives are not truly symmetric, then schemes can effectively become a way of providing increased returns to companies. This potential asymmetry is particularly apparent in applications such as these. It is highly unlikely that any other party would have either the information necessary, or the direct commercial incentive, to raise Income

Adjusting Events should National Grid have benefited from any such events. This makes IAEs a one-way process in practice.

4. Many of the specific issues that National Grid raises seem to be 'business as usual'. Transformers will fail and need replacing; this is not an 'event'. This is an ongoing issue for which a core part of National Grid's role is to understand and manage. In fact, FMJL current transformers have been a known issue to the industry for a number of years. Similarly, whilst the Alcan closure and Moyle outage may well have increased Grid's costs these are simply market occurrences which will happen, of differing types, in any given year. Grid cannot reasonably have expected that market conditions would remain unaltered when agreeing to this scheme. Again, it must be part of the System Operator role to be able to manage this effectively. It is important to note there will have been similar occurrences that have reduced Grid's cost but, due to the asymmetry described above, these are unlikely to be brought to Ofgem's attention. For example, in this incentive period, unforeseen outages at Scottish Generators have eased constraint issues and reduced Grid's costs.
5. In relation to the observed Transmission losses, we note that it is accepted that data integrity is not an issue and therefore the increase in losses is purely related to technical losses. It may be the case that National Grid are limited in the actions they can take to reduce technical losses, but National Grid were best placed to fully understand these limitations prior to accepting this symmetrical incentive scheme. We consider changes in spark spreads to once again be 'business as usual' and their impact on the location of generation relative to demand should have been understood by National Grid, and certainly we do not believe it is credible that National Grid did not fully understand and appreciate the relationship between conductor length and losses prior to accepting the incentive.
6. We hope you find our comments helpful. If you have any questions, please do not hesitate to get in touch with me.

Yours sincerely,

Andy Manning  
[Via email]  
Head of Network Regulation, Forecasting and Settlements