

Legal & Regulatory

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Electricity System Operator Incentives
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15th July 2014

Dear Lewis,

Electricity System Operator Incentives: Incentives from 2015

1. Thank you for the opportunity to respond to Ofgem's consultation on the System Operator incentive scheme to apply from 2015-17. This is a non confidential response on behalf of the Centrica Group, excluding Centrica Storage.
2. We are concerned that the inherent difficulty in modelling and forecasting appropriate targets for the Balancing Services Incentive Scheme impairs the effectiveness of the incentive. This reduces the confidence we have that the scheme is delivering benefits to customers.
3. In the last five schemes (since 2008) the incentive value has exceeded the cap or collar¹, on occasions flipping between the cap and collar. As it is unlikely underlying SO performance will vary this much year-on-year this indicates that the incentive returns are dictated largely by the target-setting and not by performance.
4. In most of these schemes costs have varied from target by such an extent that even a change in outturn costs of 10% would not have brought performance back within the cap/collar. If a range of 10% around performance makes no difference to the value of the incentive it is difficult to argue that the incentive scheme is effective.
5. Clearly, once the SO is confident that costs will fall outside the cap/collar range, the incentive properties are no longer active. Throughout 2013/14 (including before the finalisation of the 2013/14 scheme) National Grid have presented a forecast of external BSUoS ranging between £845m and £878m, compared to a provisional target of £1,100m, and so it is therefore likely they would be aware throughout the

¹ The 2011-13 was only brought back within the collar following an Income Adjusting Event

period that the cap would be reached and their performance was unlikely to affect their reward.

6. We welcome the steps Grid has taken to improve efficiency but believe this an indication of how they operate generally as a business and not as a result of the incentive scheme.
7. We would suggest that the sharing factor for the 2015-17 incentive scheme should be reduced. To the extent that the BSIS may encourage further efficient behaviour on the part of the System Operator then it must follow that it is inappropriate that the incentive should so frequently hit the cap or collar. Reducing the sharing factor will increase the range that the incentive remains active without increasing the risk to customers and Grid from the difficulties in setting appropriate targets. For 2013/4, Grid would still have achieved a reward of around £23m with a sharing factor of 10% but with the incentive property maintained.
8. Given this historic difficulty in target-setting, and the expectation is that increasing system operator challenges will make forecasting system operation costs (and targets) even more difficult in future, it is also worth reviewing whether the maximum reward/penalty available is appropriate.
9. We are unsure whether NGETs modelling or the consequential financial impacts of the SO's actions are understood by wider stakeholders as Ofgem consider and support any initiatives that introduce greater transparency and understanding of the incentive framework. This is critical given the fact that some parameters used to derive targets for the BSIS are set during the scheme without scrutiny from wider stakeholders.
10. 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