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Our Ref.

Your Ref.

21st January 2005

Dear Simon,

NGC System Operator incentive scheme from April 2005

Centrica welcomes the opportunity to provide comments to Ofgem's consultation on the initial proposals for NGC's System Operator incentive scheme from April 2005

We agree with Ofgem that historically NGC's forecasts, both for their outturn achievement against the current target and for future years, have been over estimated and we believe their modelling program is obviously flawed in this respect. We welcome Ofgem's view that this historic over estimation should be taken into account when setting the System Operator target for the GB SO. As such we are surprised by the continuation of generous targets being offered to NGC under these proposals.

Given the timescales involved, we believe that it is sensible that the scope of the GB SO incentive scheme is consistent with the scope of the current E & W scheme. However, we suggest that further work should be carried out in this area to ensure the most appropriate incentive scheme is developed going forward i.e. the development of a deep incentive scheme. This is, we believe, essential to ensure the correct incentives are levied on NGC and the downward pressure on BSUoS costs is maintained. We are disappointed to note that Ofgem have again erred on the high side of their calculated range for the target under Option 1 and this is then subsequently increased for Options 2 and 3.

We support the adoption of a single, sliding scale GB-wide incentive scheme lasting for one year. We believe that the incentive scheme should have symmetrical cap, floor and sharing factors as we do not believe there is strong uncertainty in only one direction in relation to the GB SO costs. Therefore, we believe that both NGC and the rest of the industry should experience the same "risks" to their costs.

We believe that due to the nature of the IAE process and the lack of information available to 3rd parties to enable them to raise cost saving IAEs, the target set should be on the medium to low side of any range calculated. This will enable NGC to raise an IAE, if needed, where the allowances are insufficient against the actual costs.

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We also suggest that the level of the target should reflect a fair indication of the costs. In previous years, NGC have been given generous targets with very little or no probability of exceeding them. As previously stated, we would prefer a target that is more realistic, from which there is equal probability of NGC either over or under spending. This can be used in tandem with the IAE process, especially during the first year of BETTA to ensure that NGC will not be exposed to an inappropriately large risk if there are significant differences between assumed and actual costs. Any risk should be balanced by an appropriate reward; this should include any risk to the industry as a whole. We do not believe it is acceptable for the industry to be exposed to a large risk, especially as we are not in any position to manage it, likewise the industry should not be exposed to the high probability of excessive bonus payments under this scheme.

We do not support Ofgem's stance of giving NGC three options from which to choose their preferred balance of risk and reward. This is especially in light of the very generous upside and limiting downside of Option 1, which we believe will be the likely option to be selected.

Given the comments above, we suggest that a more appropriate target figure should be between £470m. We further suggest that the sharing factors under option 1 are too generous, this is especially the case as the target of £480m has been set at the upper level of Ofgem's range. We see no reason to change the current sharing factors as we believe these provide an appropriate balance of risk between the industry and NGC. As there is some unknown costs for the GB SO, we suggest the cap and floor could be equally reduced (for one year) to £30m and -£30m respectively. This will, we believe, result in a more balanced and therefore fair scheme.

Please contact me if you have any queries regarding these comments.

Yours sincerely,

Sarah Owen
Commercial Manager
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Centrica plc - The group includes British Gas Trading, British Gas Services and Accord Energy
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