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**Response to Ofgem's Final Proposals Consultation on NGET's SO Incentives from 1st
April 2010**

Dear Guisepina,

Thank you for the opportunity to respond to your Final Proposals Consultation on SO incentives. This response is on behalf of the Centrica group of companies excluding Centrica Storage Ltd.

Centrica welcomes most of Ofgem's conclusions with regard to NGET's initial proposals for SO Incentives for 2010/2011. As we stated in our response to NGET's initial proposals, we were disappointed by the lack of information provided to justify the assertions and assumptions put forward by National Grid to support their forecasts and by the forecasting methodology employed. We were also unconvinced by NGET's justification for longer term schemes and for the unbundling of the constraints segment. Furthermore, in our response we argued that Ofgem should play a more active role to actively steer the forecasting process and as such we are pleased that Ofgem has recognised the need for more involvement.

Forecasts

A key concern of Centrica within the SO incentives consultation process was NGET's forecasting methodology. We had concerns that the forecasts relied heavily on historic relationships and drivers and we found a number of apparent weaknesses, inconsistencies or lack of clear explanation from which to make informed judgements on the forecast numbers presented. These concerns appear to have been justified given that NGET's forecast IBC has fallen from £962 million in November 2009 to the latest forecast of £601 million and also calls into question the initial forecasts used to propose increased sharing factors. It is for this reason

that we believe that Ofgem proposals for a new licence condition which would require NGET to cooperate with the Authority in undertaking a review of the methodology for developing its forecast would be beneficial.

Multi-year BSIS scheme

Although Ofgem has rejected the introduction of a multi-year BSIS scheme for 2010/11 we note that the Authority continues to advocate the merits of the introduction of such a scheme at a later date. Centrica remains unconvinced that there is a positive benefit in extending the duration of the SO incentive scheme beyond one year based on the justifications put forward to date. There has been no substantive evidence or examples provided to justify some of the assertions made about the benefits of a multi-year scheme and disadvantages of a one year scheme. Nevertheless, we note that Ofgem continues to believe a longer term scheme would be beneficial for a number of reasons, including to incentivise NGET to consider actions that have longer payback periods. In order to make a judgement of the scale of the benefits from the greater investment opportunities that are expected to arise from a multi-year scheme we believe Ofgem should undertake a detailed cost benefit analysis in this area in addition to its proposed review of NGET's forecasting methodology.

Unbundling of constraints segment

We welcome Ofgem's decision to reject the unbundling of constraint costs on the basis that it could provide perverse incentives to NGET on how it allocates costs. Centrica agrees with this view and believes that there are various other reasons why a bundled scheme remains the best option. For example, we believe that the varying risk profiles across the scheme components being included within a single scheme bring significant benefit to the industry by diversifying the individual risk profiles and allowing gains in one to be offset by losses in another. We also reject the argument that cost monitoring can only be provided by unbundling. Transparent cost monitoring can also be delivered within a bundled scheme.

Ofgem's final proposal

Ofgem's proposed target of £577.5 million would appear reasonable given the expected outturn for the current year. However, given the limited nature of the data available it is not possible for Centrica to fully audit this figure. We also agree with Ofgem's proposals to lower NGET's proposed sharing factors to 15% given the evident difficulty that NGET has experienced in providing accurate forecasts during this consultation process.

I hope these comments have been useful. If you want to discuss any element of this response, please do not hesitate to contact me on 07789 579169 or at Ricky.Hill@centrica.com.

Yours sincerely,

Ricky Hill
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