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24th June 2016

Dear Matt,

Proposed Revision to the Shrinkage and Leakage Model in respect of the Interference Damage calculation applied for incentive purposes Version 2.0

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group, excluding Centrica Storage.

We welcome that the volumes of gas lost through large release incidents (when those volumes can be estimated) will now be used in the calculation of shrinkage for the purposes of gas allocation. However, we remain concerned the proposed revision to the Model may result in a change in focus from the behaviours the Shrinkage Incentive was designed to encourage. We recommend:

- **Emphasis on the reduction in gas transport losses should be maintained.**
- **The 8-year average performance should be used to minimise the distortive effect on the 'roller' mechanism.**

Emphasis on the reduction in gas transport losses should be maintained:
In our response to the September 2015 consultation[1], we explained why it is inappropriate for emphasis to be placed on the reduction in the number of large release incidents instead of the volume of gas lost. The Shrinkage Incentive was introduced to encourage GDNs to minimise gas transport losses:

> Shrinkage refers to gas which is lost from the transportation network. It is the dominant element of companies" business carbon footprint (BCF) and accounts for more than 0.75 per cent of GB green house gas emissions. For the current price control, we introduced an Environmental Emissions Incentive (EEI) and shrinkage allowance mechanism, which both **provide GDNs with an incentive to minimise gas transport losses**[2]. [Emphasis added]

However, the proposed revision to the Model places emphasis on the reduction in the number of incidents instead:

[1] Proposed Revision of the Shrinkage and Leakage Model in respect of the Interference Damage calculation applied for incentive purposes Version 1.0 (http://www.gasgovernance.co.uk/sites/default/files/Consultation%20Paper%20No%205%202015%20-%20Leakage%20Model%20-%20Revision%20of%20the%20Interference%20Damage%20Calculation.pdf)
[2] RIIO-GD1: Final Proposals - Supporting Document – Outputs, Incentives and Innovation, paragraph 2.17 (https://www.ofgem.gov.uk/sites/default/files/docs/2012/12/2_riiogd1_fp_outputsincentives_dec12_0.pdf)

> For the purpose of determining incentive performance, the GDNs propose that the calculation of leakage in respect of large gas release incidents should be amended so as to be **based always on the number of incidents at the existing pre-defined rates**...[3] [Emphasis added]

AND

> This would still **provide an incentive for GDNs to manage the number of incidents** and, by leaving in the >500kg category, **minimise the number of large incidents in particular**, but without being exposed to the potential variation associated with actual leakage volume calculations which are out of their control.[4] [Emphasis added]

The emphasis on the reduction in the number of incidents is inappropriate because it should not be assumed that a reduction in the number of incidents will always result in a reduction in gas transport losses. The proposed revision could inadvertently weaken the incentive on the GDNs to reduce gas transport losses and it may represent a deviation from the original policy objective of the Shrinkage Incentive.

Given our concern outlined above, we recommend the current approach to calculating the volume of gas lost through large release incidents is retained for the purposes of the Shrinkage Incentive.

The 8-year average performance should be used to minimise the distortive effect on the 'roller' mechanism:

We understand the potential impact on the incentive scheme of large gas release incidents, especially if they occur in the last year of the price control (due to the importance of this year to the roller mechanism). We agree that the performance in any given year is not necessarily representative of underlying performance. Therefore, we suggest that volumes of gas lost through large release incidents (when those volumes can be estimated) in the final year of the RIIO-GD1 price control are replaced with the 8-year annual average. We believe this approach is preferable because the effect of the final year performance on the 'roller' mechanism is mitigated, while focus on behaviours agreed at the outset of the RIIO-GD1 price control is maintained.

We hope you find these comments helpful. Answers to the questions included in the consultation are attached. Please do not hesitate to contact me if you have any questions.

Yours sincerely

Andy Manning
Head of Network Regulation, Forecasting and Settlements

[3] Page 6 of the consultation document.
[4] Page 6 of the consultation document.

Q1. Do you agree that it is appropriate to amend the leakage volume calculation in the Interference Damage methodology, used for determining incentive performance, to be based always on the numbers of incidents at the existing predefined leakage rates?

We do not agree because we are concerned the proposed revision may result in a change in focus from the behaviours the Shrinkage Incentive was designed to encourage. Further, it is may result in a deviation from the original policy objective the Shrinkage Incentive was designed to achieve.

Q2. Do you agree that the proposed revisions to the incentive baselines in Appendix A are appropriate?

We do not agree that the baselines should be revised. We recommend volumes of gas lost through large release incidents (when those volumes can be estimated) in the final year of the RIIO-GD1 price control are replaced with the 8-year annual average to mitigate against the effect of final year performance on the 'roller' mechanism.

In the interest of transparency, we recommend the methodology and data used to calculate baselines are included in future modification proposals and for revised baselines to be subjected to external scrutiny.