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By e-mail

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Dear Cheryl,

Re: Transmission Access Review – Enhanced Transmission Investment Incentives: Initial Proposals

Thank you for the opportunity to comment on the above consultation. This is a non-confidential response on behalf of the Centrica group of companies excluding Centrica Storage Ltd. The response includes our high-level views on key areas raised in the consultation document.

Initial proposals

Funding framework

We welcome Ofgem's proposed decision to opt for a simple and pragmatic funding approach for additional investment within TPCR4 and not to introduce new enhanced financial investment incentives. We believe this approach is required to ensure timely (anticipatory) investment in the transmission system necessary to meet the 2020 targets, support security of supply and reduce constraint costs. We remain, however, concerned about Ofgem's proposal to limit the funding to costs incurred up to the end of TPCR4 (and possibly an earlier end date) and the impact that this could have on the delivery and financing of transmission investment.¹

We are supportive of the eligibility criteria for construction funding to ensure a balance is struck between timely investment and protection of consumers from unnecessary and inefficient investment. However, if there is uncertainty about the need case and scope of a particular project but the investment could make a substantial contribution – at proportionate costs – towards meeting the policy objectives mentioned above, then we believe funding for anticipatory investment should be allowed by Ofgem and this decision should not be further delayed. If this is indeed Ofgem's intention, as appears to be suggested in the consultation document, we would very much support this approach.

The consultation document states that the downside of this approach, although offset by advantages, is the transfer of risks associated with anticipatory investment from TOs to consumers. We would like to put this into context and note that consumers are currently exposed to the (arguably far greater) risks and financial consequences of insufficient investment in the transmission system.

¹ We are not supportive of extending TPCR4 by 1 year, as outlined in our response to Ofgem's recent consultation on the subject.

Funding mechanism

If Ofgem were to implement the initial proposals as outlined in the consultation document, our views on the key elements of the funding mechanism are as follows.

Opex/capex

We agree with Ofgem that considering the level of pre-construction costs for the remainder of TPCR4 and the potentially significant impact on TNUoS charges, these costs should, where possible, be treated as capex similar to the proposed treatment of construction costs.

Price control

We support Ofgem's view that re-opening of price control decisions should be avoided and that therefore for the additional investment projects the same rate of return should apply as adopted under TPCR4. To maintain consistency with TPCR4 we believe that no change should be made to the existing capex efficiency mechanism and the existing 25% sharing factor should not be amended. We do agree with Ofgem that, given the proximity of the planned spend, the ex-ante allowance should not be index linked.

Income Adjusting Event

We understand that the funding mechanism will include a provision for raising an Income Adjusting Event (IAE) to seek and adjustment to the ex-ante allowed revenue if there is a material unforeseen variation in costs other than a change in unit costs. Given the qualification, we would welcome examples of variations in costs that could trigger an IAE.

Way forward

To ensure timely network investment and to avoid the need for additional financing costs associated with deferred cash flows, we believe it is important that Ofgem's original timetable with implementation of relevant licence changes by April 2010 and inclusion of additional revenue allowances in the 2010/11 TNUoS tariffs is maintained. We welcome Ofgem's commitment in that respect.

We note that Ofgem's proposal is to publish the Final Proposals document mid January 2010 and that the statutory licence consultation will take place end of February 2010. It would be helpful if draft licence conditions were published together with the Final Proposals document to allow sufficient opportunity for the industry to consider the proposed changes and enable any required amendments to be made before 1 April 2010.

We hope our comments have been helpful. If you have any questions regarding this response, please do not hesitate to contact me.

Kind regards,

Merel van der Neut Kolfshoten
Centrica Energy