

Timetables for price control reviews

Ofgem proposes the extension of the current NGC price control by one year so that the next main price control period for NGC will commence in April 2007 coincident with the next Transco transmission price control. This will enable NGT's transmission functions to be considered in a single review and thus better reflect the degree of integration between Transco and NGC following the merger. We welcome this proposal.

Ofgem has also proposed the extension of the current gas distribution price control by one year. We consider that it would be preferable to conduct the gas distribution and transmission reviews concurrently, due to the sharing of functions and costs between the transmission and distribution businesses. However, we recognise the practicalities of so doing and therefore agree in principle to both proposals.

As Ofgem's letter recognises, there are significant issues that will need to be dealt with to extend the respective controls by one year. However, we agree that a full price control review would not be appropriate or proportionate. Therefore, as suggested, it would be appropriate to apply the assumptions underlying the existing controls with adjustments only where evidence clearly demonstrates that these assumptions, particularly assumptions about required expenditure, are obviously inappropriate. The starting assumption for **controllable opex**, for example, could therefore be an extrapolation of the rate of reduction assumed in the current controls. Possible reasons for going beyond such extrapolation might include **pensions** and, on the gas distribution side in particular, any introduction of **lane rentals**.

Any interim price reviews will be against the background of 'price review' work which is being triggered by other factors, e.g. **BETTA and the network capex requirements of renewable generation developments**. Related to the latter, it is likely that there will need to be at least a '**mini**' **capex review**. Such reviews (i.e. for both transmission and, in time, for gas distribution) could also both review likely overspend against Ofgem assumptions for the current price control period and also decide whether the material underlying rise in required asset replacement in electricity transmission should be reflected in allowed revenue during the one year extension of the current control.

It is our view that both the **implementation costs and additional underlying operating costs associated with BETTA**, as determined by an exercise which is already under way, can simply be added on to existing NGC revenue streams (through the SO control if necessary, as was done for NETA), at least through to March 2007. There will, of course, need also to be an adjustment to the TO revenue stream to reflect any change in the regulatory status of the interconnector between England and Scotland.

On **cost of capital**, it would be disproportionate to undertake a full cost of capital review for the respective NGT functions, not least because the current electricity distribution price review (DPCR4) should provide an adequate basis for a 'reads across' for a one year extension of the NGC control. By the time that the gas distribution controls need to be extended, there will also be the results of work undertaken for the next full electricity and gas transmission price review.

One issue which does not fit easily into the above framework is **gas distribution repex**. The tri-partite Transco/Ofgem/HSE review of the repex programme is intended to be carried out in time to set allowances for 2007/8. Rather than carry out

a review for 2007/8 and another for 2008/9-2012/13, both of which would in any case need to look at workload over a longer timescale, it might be more sensible to carry out a single review covering the six year period 2007/8-2012/13.

In addition, to the extent that any distribution network has replaced greater lengths of pipe than envisaged by Ofgem, the treatment of this expenditure should be considered as part of the one-year extension rather than deferring the issue for a further year. Should Ofgem wish to extend the capping of repex allowances to future review periods, then it would considerably reduce flexibility if Ofgem applied a one-year cap for the extension to the control. Therefore if a cap is to be applied it should cover the extension and the next main review period. This would be facilitated by the six-year tri-partite review described above.

Timing of interim reviews.

Consideration will also need to be given to the timing of any interim reviews, particularly of capex issues. Clearly, the NGC review needs to take place between now and March 2006 when the current control expires. We would favour an earlier, rather than later, review, perhaps during Spring/Summer of 2004. We note that the Scottish transmission businesses will need to be reviewed in a similar timescale due to the earlier expiry of their current controls. An early review of NGC's costs for 2006/7 could therefore be managed in conjunction with the Scottish Reviews and would reduce uncertainty over the funding of renewable investment and how investment to facilitate the government's renewable targets will be remunerated.

We would favour analogous timing for the gas distribution mini review, i.e. Spring/Summer 2005.

National Grid Transco
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