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7 April 2004

Dear David

Response to Review of transmission price controls from 2005

We welcome the opportunity to comment upon the two-year roll forward of the Scottish Transmission companies price controls for the period April 2005 to March 2007. As stated in the document, NGC's current control needs to be rolled forward by a year, and therefore we have a common interest in the approach to be taken.

Development of the price controls

We agree with the sentiment in paragraph 3.3 that the review should be proportionate and that a full review is not merited for a two year roll-forward. Nevertheless, we believe there are certain important issues, especially with respect to the treatment of past and future capex, which should be considered at this time.

We believe that, in the first instance, Ofgem should aim to base roll forward allowances on the assumptions underlying the existing controls. However, it should apply corrections where it is clear that costs have needed to deviate from those assumptions. Investment to facilitate renewable generation is an example of an area that merits further consideration in this regard.

Ofgem has recently published, in its considerations upon gas and electricity distribution, criteria for incorporating capex in excess of allowances into the RAV and remunerating foregone return and depreciation. It would seem logical for similar criteria to be used for transmission. However, this mechanism should be intended for dealing with unforeseen outcomes, e.g. higher than forecast demand, on an ex-post basis. It should not be relied upon to address future issues that are already known about such as reinforcements to accommodate renewables. We are aware that Ofgem is planning to review the case for this investment in both Scotland and in England and Wales and we support these plans.

We would expect Ofgem to assess actual and proposed expenditure with a view to adjusting the RAV and, where appropriate, provide retrospective remuneration. Such a process might be too intensive for the rollover review. However, where the relevant expenditure is material, Ofgem could give thought to making a provisional adjustment to

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revenue for the rollover years on the understanding that a full true-up would follow at the next main review.

Interconnector charges

Section 2.22 suggests that NGC charges separately for pre and post-vesting components of the Anglo-Scottish interconnector. This is incorrect. Users are levied a combined charge to remunerate the provision of interconnector assets owned by NGC as well as the Transmission Business's Connection and Transmission Network Use of System charges.

Section 2.46 states incorrectly that NGC's use of system charges are charged directly to Interconnector Users. Transmission Network Use of System Charges are paid by interconnector asset owners, i.e. NGC's Interconnectors Business in the case of the Anglo-Scottish interconnector. Balancing Services Use of System Charges are paid by the lead parties of the Interconnector BM units registered by Interconnector Users.

Sections 2.29 to 2.35 explain the revenue controls relating to the interconnector. NGC believes the Agreements reached with the Scottish companies are in accordance with our licence duty to recover no more than a reasonable rate of return on the capital represented in the interconnector and these contracts should continue until BETTA go-live.

Excluded Services Revenues

Section 2.41 describes excluded services revenues and states that in the last review these were deducted from price control revenues. We draw your attention to Andrew Walker's open letter dated 30 October 2001. The application of this letter means that, going forward, only 50% of actual revenues associated with telecom services (algged two years) should be included in price controlled revenues. This incentivises companies to make these services available to the overall benefit of consumers.

We note from paragraph 2.41 that no excluded services revenues due to demand or generation connections were forecast at the last review. The footnote to this paragraph gives the reason that customers make capital contributions towards these charges and states that such contributions are not treated as excluded services but rather are netted off gross capex. We note that, if recent changes in England and Wales to the boundary between connection and infrastructure assets are implemented in Scotland post BETTA Go-live, then this will have implications for the future treatment of excluded services in Scotland.

BETTA adjustments

Section 2.52 proposes that if BETTA is significantly delayed then consideration should be given to including an allowance in the roll forward price controls to recover implementation costs. We agree with this proposal, as there appears to be no benefit to consumers in delaying recovery of these costs. Indeed, even on the assumption that BETTA will be implemented on time, then it may be appropriate for the baseline set by the roll forward price controls to include BETTA implementation costs that are already known and have been or will be efficiently incurred.

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To the extent that BETTA is implemented mid-year, paragraphs 2.56 to 2.57 propose a pro-rata approach to price control allowances pre and post-BETTA. It should be noted that, in setting charges, companies may need to derive their charges from forecast peak flows/capacities over the course of the charging year. Therefore, pre and post-BETTA charging rates may not be reflective of the flows and capacities occurring during the pre and post-BETTA periods.

The transition from pre to post-BETTA charges and from recovering revenues directly to recovering revenue through the GBSO is a non-trivial exercise. Customers will require adequate notice of the changes to their charges in accordance with the terms of connection and use of system agreements. Late changes to the implementation date could, therefore, impact upon the ability of the GBSO and the transmission companies to recover their allowed revenue or could result in very significant swings in revenue.

Process

One of the benefits of Ofgem's recent re-organisation was that it brought all network investment under a single directorate, thus facilitating consistency between price controls. However, we note that Ofgem's BETTA team is conducting this review. Whilst this will facilitate consistency between baseline costs and the adjustments for BETTA, we would hope that, in conducting this review, the BETTA team would have regard to the approach to network monopoly price controls that is being developed elsewhere.

We look forward to the update on progress of the roll-forward review. Please contact me if you have any questions on the points raised in this response.

Yours sincerely

Tim Tutton