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25 June 2004

Dear David,

Transmission Price Controls and BETTA - Update

I refer to the above consultation. In summary, we believe that a straightforward roll-forward price control can be delivered for a further two years. This should be based on a limited review of the business plans of the licensees with adjustments to reflect the socialisation of the interconnector and the introduction of BETTA, including any costs associated with revision of the connection boundary in line with the NGC methodology. The cost of capital should be set at the rate applicable for the DNO review. Our comments on the particular issues raised in the consultation are detailed below.

Output Measures

Except for one area of activity, there is little underlying change in transmission requirements compared to the last price control. That area relates to generation connections, and in SSE's area significant numbers are able to connect prior to the major infrastructure upgrades being discussed in other Ofgem consultations. SSE's investment plans contain a small increase in infrastructure investment to accommodate these generators.

Asset replacement activity continues broadly at existing levels.

Roll Forward basis

We agree that the roll forward should continue as an RPI-X form of control with a limited review of the licensees' business plans and performance. A comprehensive

review would be inappropriate at this stage since it would create uncertainty for investors as well as being a significant further demand on limited resources, particularly with BETTA implementation plans.

The costs of capital should equal the figure to be agreed for the distribution price control review (DPCR), to avoid perverse incentives between the regulated businesses.

Depreciation should similarly use the same assumptions as in the DPCR.

We agree that the RAV should be rolled forward using the methodology employed in previous price controls. We also believe that Ofgem's proposals for should incorporate the new 5 year retention period for opex and capex savings, as per the distribution proposals.

BETTA

We agree that the implementation and operational costs of BETTA should be recovered as an additional charge on GB customers through BSUOS

A particular item that does need detailed work in setting the ongoing price control is the change in connection boundary under BETTA. In SSE's area, many existing generators have paid or have been quoted for a "deeper" connection charge than NGC's super shallow "plugs" methodology. This will mean that, like NGC, some monies will have to be refunded to parties already connected. Also some planned investment which would be recovered through the connection charge will have to be added to infrastructure investment. Both of these issues will need to be resolved before the price controls can be finalised.

Interconnector

We agree that the interconnector should be socialised at a market related valuation. In our view, this should reflect the NPV of the revenue stream which would otherwise have been obtained through the contractual arrangements. For SSE, this implies a RAV addition of £25m.

Incentives

We agree that the only area where there is scope for incentives on the TOs is in outage planning. However, since the TOs are required to ensure that any charges reflect the cost of moving outages, the TOs are neutral to such incentives. In particular, SSE has assumed that there will be no loss of efficiency in outage planning as a result of BETTA. This means that no costs have been assumed in the business

plan for moving outages at short notice, nor has any income from the GBSO been assumed.

There will, however, be a significant impact on NGC's incentive scheme, principally due to the additional costs of providing balancing services in Scotland.

We agree that the Gt term should continue to apply only to generation connecting in NGC's area pending a full review of such incentives for implementation in the 2007 price control.

It would also seem to be consistent for the rearrangement of outages not to be treated as an incentivised balancing cost, since this is how NGC currently deal with these costs. However, it should be noted that we have not assumed any income or costs in our business plan for short notice rearrangement since this is not a feature of our current arrangements.

Timetable

To deliver BETTA in April 2005 it is essential to resolve the price control issues discussed in this consultation. Ofgem also intend to consult on licence obligations to ensure the timely implementation of BETTA. It is therefore clear that the price control issues have to be resolved before the BETTA licence conditions are implemented. Without this, the transmission licensees would be under an obligation to implement BETTA irrespective of the outcome of the price control discussions, which would be unacceptable.

If you require any further information on any of the above, please give me a call.

Yours sincerely,

Rob McDonald
Director of Regulation