

Prospect is a trade union representing 104,000 scientific, technical, managerial and specialist staff in the Civil Service and related bodies and major companies. In the energy sector, we represent scientists, engineers and other professional specialist staff in the nuclear industry, the wider electricity supply industry and, increasingly, also in the gas industry. Our members are engaged in operational and technical management, research and development and the establishment and monitoring of safety standards, environmentally and in the workplace.

RESPONSE TO THE OPEN LETTER ON EXTENDING NATIONAL GRID COMPANY'S TRANSMISSION OWNER PRICE CONTROL FOR 2006/7

This letter:

- Highlights the reasons for extending the current price control for a further 12 months to 31st March 2007;
- Valuing the regulatory asset base;
- Setting NGET's capital expenditure base for 2006/7;
- The appropriate cost of capital; and
- Setting NGET's operating expenditure base for 2006/7

Extending the price control for 12 months

These issues were outlined in the May 2004 consultation document. Following the creation of National Grid and Transco, there has been considerable integration of several aspects of the business and a single review period for both gas and electricity gives our members greater certainty, as there will be a single process of reorganisation in response to the price review. We do not take issue with the extension to align the gas and electricity transmission review periods.

Valuing the regulatory asset base

Given the vast increase in capex in 2004/5 driven by the wish to improve system reliability, which has substantial public and political support, there is a need to revalue the regulatory asset valuation (RAV) before 2007. Whilst Option 4 appears to be the best option as the only realistic alternative, Option 2 places a significant financial burden on NGET and may increase uncertainty. Ofgem needs to recognise that customers want a balance between reduced costs and improved reliability.

We would also query why Ofgem has selected the low scenario view of the RAV from the information provided by PB Power. Given the skill shortages in the electricity sector, attempting to trim spending sends the wrong message to both regulated companies and contractors facing a significant initial financial commitment to reinvigorating and extending training schemes for craftspersons and professional engineers.

A key issue raised appears to be the Ofgem concern over the appropriateness of any spend during 04/5 driving towards the low scenario adopted. Clearly the validity of this spend is however testable in this respect and the views of PB power tend towards full justification of the spend incurred and inclusion in the RAV. The confidence of NGET to incur such costs ahead of any agreed revenue stream for that investment further demonstrates the validity of this expenditure.

What this issue does however demonstrate is the inappropriateness of previous regulatory structures in the context of an increasing asset renewal and network development requirement. More flexible regulation forms allowing more efficient treatment of such issues in the future (e.g. via defined capital adjustment factors and metric based evaluations) should be considered

In NGET the impact upon internal resources of delivering an increased level of expenditure in 04/05 should not be underestimated. Whilst delivering against OPEX targets NGET staff have also out-performed in efficiently delivering an increased capital programme. This achievement should be recognised in the context of the single year control and its opex targets. Our members are committed to deliver the significant increases in capital expenditure, however with such increases comes an increased resource commitment that our members would be unable to support were Ofgem to apply significant cuts to OPEX allowances over the period.

Setting NGET's capital expenditure base for 2006/7

Given the pressure to improve customer service now and the pressures on skills, the further exploration of option 4 based on a lower level of spending up to 2003/4 seems contrary to the public interest. Option 3 is more reasonable but it seems to ignore the advice of Ofgem's own consultants by opting for the low scenario that reduces capex by £100 million from the mid-range estimate of £518 million to £417 million: delaying necessary investment in this way reduces the potential reliability of the transmission system for minimal financial benefit to customers in 2006/7.

The appropriate cost of capital

Given the decisions made in the distribution price control review (DPCR4), Options 2 seems the most reasonable as it provides a consistent basis for evaluating cost of capital across the electricity sector and reduces uncertainty in the minds of investors who might interpret any other option as a sign that Ofgem intended to change the decisions made in DPCR4. Given the long-term nature of investment in electricity networks a consistent long-term approach is desirable as it reduces the risk element contained in the cost of capital.

Setting NGET's operating expenditure base for 2006/7

Given the pressures on National Grid's pension scheme, it is undesirable that pension costs should not be considered in the extension of the existing price control and a clearer signal that any shortfall for 2006/7 will be reimbursed completely in the full review is necessary. Given the skill shortages in the industry this approach to pensions places National Grid at a potential competitive disadvantage compared to DNOs who have these costs passed through to customers. In effect NGET's shareholders are asked to stand the risk that Ofgem changes its position before the 2007 review to the Company's disadvantage.

It should also be noted that in the context of increased asset renewal and network development requirements in 2006/7 the appropriate balance between in-house and out-sourced resource should be considered. A good example of this is overhead line activity where the scoping and assessment work of projects may better sit within the internal field resources of NGET than with the contractor in an environment where the contractors resource is better maximised in the installation of an increasing level of new assets

It is Prospects view that against a context of a higher volume of delivery the efficiency of the delivered programme is greatly influenced by the levels of internal resource available to contract, specify, support, procure and validate against the programme under consideration. As stated earlier our members are committed to the delivery of this programme and would welcome from ofgem incentives to ensure NGET resourcing of that programme against agreed metrics (e.g. unit costs, delivery timescales) and that allows NGET to develop its internal skills base to meet increased pressures upon it.