



taking care of the essentials

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Our Ref.
Your Ref.
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Dear Mr Hull,

Transmission Price Control Review - Initial Consultation

Centrica welcomes the opportunity to provide comments to Ofgem's initial consultation on the Transmission price control review.

We have undertaken to provide answers to as many of the questions posed in Chapters 4-7 as possible.

Chapter 4 Framework, context and objectives

◆ External factors cited in 4.11

The closer links between gas and electricity networks, resulting from the increased proportions of gas-fired power stations, does not have any direct effect on the price control review. We suggest that the economies of scale and efficiencies enjoyed by National Grid (NGrid), as owners of the NTS and the majority of the Electricity transmission system, have a greater impact on cost drivers for the review.

We believe that the significant increase in both distribution-connected and renewable generation needs to be carefully tackled to ensure the correct and appropriate signals are maintained. In addition, Ofgem needs to have potential regard to the development of an offshore electricity transmission system to accommodate renewable generation.

~~NGrid's role as GB SO should, we believe, deliver significant cost savings and overall efficiencies; these should be represented by a downward pressure under the SO incentive scheme which is seen by the industry to have been overly generous since the implementation of NETA.~~

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The general principal for price controls should be that any external factors that are easily predictable or assessed should be included within the elements of the price control. Any

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other external factors that are unpredictable or inconsistent should be considered under a re-opener at the appropriate time.

◆ RPI Indexation

We see no reason to change from the current RPI-X indexation. There should, moreover, be an aligned approach, across the various price control regimes associated with NGrid, i.e. both gas and electricity and both transmission and distribution. We also believe that any sliding scale incentive arrangement must have a fair risk associated with the target set, i.e. there should be equal chance of both over and under spending against this target with appropriate exposure to costs and sharing of benefits.

Any de-regulation of activities can only be considered in areas where there is proven to be sufficient competition. We do not believe this is currently the case within the core areas of these businesses.

◆ Areas of Licencees' activities

As previously stated, the most important area to be considered under the review, would be the efficiencies gained by NGrid becoming the GB SO and the associated long overdue reform of the SO incentive scheme. We suggest the incentive scheme has been overly generous for a number of years and requires a full investigation to prevent the industry from incurring additional costs into the future.

◆ Incentives to reduce costs

We maintain that there have been several instances where targets have been easily met, most markedly within NGrid's SO incentive scheme, and therefore these incentive signals still require to be strengthened.

◆ Rolling Incentives

We believe that rolling incentives are appropriate for transmission as they ensure that expenditure is undertaken at the appropriate time and not linked to the start of a new price control period.

As the rolling incentive approach adopted in gas for incremental entry capacity has never triggered a signal for NGrid to invest, we do not support this scheme being adopted within the electricity industry. In addition, the current review of the UCAs associated with the long-term entry capacity auctions has, we suggest, undermined the industry's confidence within this area. In evidence provided with the consultation it is asserted that the primary tool for deriving forward cost allowances (Transcost) is severely compromised and may be unfit for purpose. Until the industry has greater confidence in the processes such arrangements are unlikely to produce any meaningful investment signals in the future. As such it should not be considered a viable option, either for other regimes within the gas industry, or for the electricity industry.

◆ Strength of incentives for efficiency in operating costs and capital expenditure

It is important to ensure that no perverse incentives are created due to incentives being unequal i.e. the capitalisation policy.

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Chapter 5 Assessing Costs

◆ Capital Expenditure

We concur with Ofgem that assessing the correct level for capital expenditure will be a difficult task, and agree that as much information should be gathered and analysed as possible to ensure this assessment is both backed up by reasoned information and is as accurate as possible.

◆ Cost reporting

We agree that, as adopted for electricity distribution parties, the Transmission companies should submit more information. This will ensure that any anomalies can be assessed and will provide an ongoing assessment in preparation for future price controls.

Chapter 6 Incentives

◆ Signalling of future requirements

We believe that a productive and effective planning regime would be more effective at determining the future requirements of the system. We believe that the uncertainty of the UCAs in the entry capacity auctions, after such a short period of time, has reduced the confidence in the industry to participate and commit to long term access requirements.

◆ Consistency between gas and electricity transmission and for entry and exit arrangements

We do not see the need for consistency between gas and electricity transmission or for entry and exit arrangements. It is more appropriate to design the correct incentives for each industry, taking into consideration the limitations of each and ensuring (given the presence in both sectors of NGrid) that no perverse signals are created under the incentives. We suggest there are fundamental differences between the two industries and it is not in the customer's best interest to try and align or underestimate them.

◆ New users - firm commitment

We would prefer to see bi-lateral agreements adopted to cover this aspect.

◆ Baseline and incremental outputs

We strongly oppose changing the definitions of the baselines. We believe that it is essential that baselines are delivered and any incremental capacity is added to the baseline, which again is a deliverable capacity. Any change to the definitions, and the ability of the licensees to under deliver against these baselines, unless there are clear and transparent exceptional circumstances, undermines the entire process.

We suggest that the methods used for determining baselines within the gas and electricity networks do not need to be the same but should be appropriate to the network concerned. The same applies to entry and exit capacities.

◆ Incremental capacity

Generators can currently procure additional capacity (up to the level of their connection agreement) through the use of STTEC or by applying to raise the level of their TEC. Additionally, NGrid has a licence obligation to provide an offer for connection to the system for new users. We do not believe this area should be separately incentivised by Ofgem as this is already a licence requirement and separate treatment may conflict with the incentives already placed on the SO.

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◆ Re-opening of price controls

As stated in the consultation, re-opening a price control should only be considered where there is an unforeseeable and significant revenue shortage (or conversely where there has been unforeseeable and significant revenue excess), meeting the criteria of an Income Adjusting Event. This, by definition, results in a price control that should offer both licencees and network users sufficient stability over the price control period.

We therefore support, as far as practicable and as long as this does not result in undue complexity, Ofgem's use of revenue drivers to ensure the allowed revenue is automatically adjusted without the need for re-openers.

7 Financial issues

While we understand the need to ensure that network operators are not excessively highly geared, we agree with Ofgem that users and customers should be able to participate in the benefits of reasonable adjustments to gearing levels. We therefore propose that Ofgem should take into account not only the actual gearing levels of the TOs, but also developments in gearing across the UK network operators more generally, including the DNs recently acquired from NGrid.

The timing of capital investment has always been an issue within price controlled companies. With the added difficulty in gaining planning permission, this is likely to become increasingly problematic. Any review of the price control needs to ensure that NGrid are incentivised to invest in a timely and appropriate fashion. We also suggest that further work needs to be undertaken to reconsider the risk profile of the industry (and hence cost of capital) based upon recent valuations of regulated businesses in the GB and NI markets.

Lastly, we suggest that where a regulated company has, through its own commercial decisions, overspent on its capital allowance, there should be no advantage gained through a beneficial rate of return on the increased asset base. Likewise, we suggest that where a substantial increase in capital expenditure has been forecast by a licencee, we would expect close scrutiny and justification of the increase before it is accepted and close monitoring during the price control.

I hope you have found this response useful. Please contact me if you have any queries regarding these comments.

Yours sincerely,

Sarah Owen
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