



*taking care of the essentials*

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Our Ref.  
Your Ref.  
25 October 2005

Dear Colin

**Extending National Grid Electricity Transmission Ltd's Transmission Owner Price Control for 2006/07**

Thank you for the opportunity to comment on the initial proposals for extending NGET's price control.

**Treatment of CAPEX Overspend - Interim RAV**

We are very concerned over the level of overspend for capital expenditure against unadjusted allowances that NGET has made over the last five years since the price control was set.

To include the majority of this expenditure in the interim RAV subject to further investigation, is, we believe, sending incorrect signals to NGET. Price Controls are set to control expenditure, any overspend in relation to the price control should have to fully explained and justified in order to be added to the RAV. This should be an open and transparent process, in which the industry is given both sufficient information and the opportunity to respond to specific details of the overspend.

In addition, any overspend that is significantly higher than that agreed in the price control should have to be justified in its own right. An overspend of over 30% against the price control, should be prompting serious questions from Ofgem, and at this stage in the process, NGET should be in a position to provide answers if they wish this amount to be considered for inclusion within the interim RAV.

Furthermore, we suggest that NGET have had plenty of opportunity to gather and provide sufficient information supporting this reported level of additional expenditure and have up to now failed in this regard.

We are further concerned that Ofgem do not include in Table 2.2 the adjusted Capex, flexed in light of the reduced level of generation connected to the transmission system

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during the price control period. This would have allowed an informed comparison of the actual spend against the flexed TPCR proposals.

We suggest it is essential that price controls are set in a fair manner and any digressions from allowed revenues outside the set down rules to increase or decrease them, should be subject to rigorous investigation before they are accepted.

We agree with Ofgem's statement in section 3.26, where it states "Ofgem considers that NGET have not provided sufficient information to support their reported expenditure for the current price control.....we reject NGET's comments that the interim RAV should be based upon their reported and projected spend."

In summary, we do not support the inclusion of the majority of this CAPEX expenditure in the interim RAV without full justification by NGET. We do not support the inclusion of this amount pending further investigation during the main price control review as we believe this is a highly inappropriate action for this magnitude of overspend.

### **Operating Expenditure**

Following the merger of National Grid and Lattice, National Grid Transco stated that the merger would result in opex savings of £100m across its businesses with expected further annual savings in gas and electricity transmission operating costs of £20m per year. In addition, there is some evidence to suggest that these savings may be exceeded in the extension year.

In light of this knowledge, we suggest that Ofgem should, at the very least, reflect an appropriate level of reduction in the operating costs based on these statements. To not do so, would be to fail in its duty to protect the interest of customers

We do not believe that a 2.5% saving - a reduction of £4.4m - is an appropriate reduction to the level of operating expenditure.

### **Capital Expenditure**

As NGET's forecast of their capex is significantly higher than either the current or historical expenditure, Centrica believes there should be detailed justification for this increase.

We are concerned that Ofgem have increased their initial proposals for the capital expenditure to be over 10% higher than the higher preferred option set out in the July open letter despite receiving no new evidence in support of a higher figure (paragraph 3.14).

We believe that due to the high level of disparity between NGET's current spending, Ofgem's view and NGET's forecast for next year, it would be more appropriate to set a lower level of capital expenditure with a revenue driver to flex this amount due to significant investment in set areas.

We concur with Ofgem (paragraph 3.18) that the onus should be on transmission owners to provide sufficient information to fully justify their capital expenditure programmes and the associated forecast levels of spend.

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

Yours sincerely,

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