

Colin Green
Senior Manager – NGET price control extension project
Ofgem
9 Millbank
London
SW1P 3GE

25 October 2005

Dear Mr Green

Consultation on initial proposals for extending National Grid Electricity Transmission Ltd's transmission owner price control for 2006/07

Introduction

energywatch welcomes the opportunity to comment on this consultation paper.

There has been an intention on Ofgem's part to align the review dates of the transmission price controls for all transmission asset owners in both electricity and gas for some time. The current consultation highlights Ofgem's proposals relating to NGET's electricity transmission price control, which would lapse on 31 March 2006, but which Ofgem wishes to extend by one year so as to facilitate the proposed alignment of transmission price controls from 1 April 2007. We welcome this development as there are clear benefits arising from alignment, not least that a proper assessment can be made of the interactions between gas and electricity markets in this respect, providing an opportunity to set price controls and allowances for operating and capital expenditure on the transmission networks which maximise efficiency across these markets. We are fully supportive of the process to extend the price control.

Capital expenditure

Ofgem provides an outline of how it has assessed NGET's request for increased capital expenditure when compared to its 2005/06 allowance, and has reached the conclusion that some, but not all, of NGET's request is justified. It is noticeable that Ofgem's consultants have had concerns about the quality of information provided by NGET in seeking to justify its request for a substantial increase in allowed expenditure in 2006/07. We support Ofgem's simplified approach to determining capital expenditure for the one-year extension period as proportionate, avoiding the need for detailed assessment of costs. We also support Ofgem's view that NGET and all other transmission companies must be more forthcoming on their requested levels of expenditure when the aligned price controls proper are set from April 2007. Without adequate justification for these allowances, it is unacceptable for transmission companies to expect increased expenditure to be approved when this may have a detrimental impact on consumers' interests, further increasing the cost

of gas and electricity at a time when there are already significant rises in prices.

Valuing the asset base

Ofgem provides an analysis of how it intends to determine the interim Regulatory Asset Value (RAV) for the purposes of the one-year extension. Again, we agree that a limited analysis is a proportionate approach in the setting of the interim RAV. We also note, as with capital expenditure, that NGET has not furnished Ofgem with adequate information to set the interim RAV. We agree with Ofgem's intention to use NGET's reported and projected spend for load-related capital expenditure, given that only an interim RAV is being set, if NGET provides the appropriate information to justify its view that this expenditure is customer-driven. However, we will take a close interest when the full price control review is underway as to whether NGET is providing a realistic assessment of its expenditure requirements.

Cost of capital

Ofgem indicates that it will carry forward the current pre-tax real rate of return of 6.25 per cent into the one-year extension period. We agree that, in the absence of strong evidence that another more appropriate cost of capital value should be used in the short term, the use of 6.25 per cent meets the requirements of the extension of the current price control. We look forward to considering this aspect of the price control when the next full review takes place.

Conclusions

energywatch is generally supportive of Ofgem's approach that the current price control should be extended by one year, and believes that the various elements of the price control are being determined in the most proportionate way, given the short period of time under discussion. energywatch shares Ofgem's concerns about the quality of information provided by NGET in setting the price control for the extension period and we hope that this will not be reflective of NGET's approach when the full review is undertaken in due course.

If you do wish to discuss any of the points made above in more detail please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs