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Dear Mr Hull

## **Transmission Price Control Review: capital expenditure projections 2007-2012**

### **Comments**

energywatch welcomes the opportunity to reflect on the issues raised in the letter.

We note the projections for proposed capital expenditure put forward by all the transmission companies for the next price control period, indicating that there are significant 'soft' or uncertain costs. We also note the considerable step change in the amount of capital expenditure which is thought necessary in the next price control compared to the current one, which is driven by investment in new (load-related) infrastructure to accommodate connections of renewable generation and gas storage. The amounts are at least double for electricity and almost double for gas.

The factors which are relevant to Ofgem's assessment of all such expenditure should be in line with its objectives for the Transmission Price Control Review (TPCR) as a whole. First and foremost, therefore, Ofgem should seek to protect the interests of gas and electricity consumers to ensure that transmission network investment is efficient, cost effective, timely and provides secure supplies of energy. We would support Ofgem in considering the forecasts of capital expenditure on this basis.

The promotion of social and environmental objectives, and the appropriate allocation of risk, is also important. However, due to the uncertainty surrounding the levels of additional capital expenditure required, as outlined in this paper, consumers require comfort that investment will involve real benefits for them. Proposed investment must have a firm basis, not be speculative, with actual users lined up to use refurbished, replaced or new network infrastructure, thereby also avoiding the construction of stranded assets. If real efficiency savings are made as a result, these must be shared with consumers.

Capital expenditure which is 'soft' or uncertain (and which may amount to around £1.6 billion for electricity and £600 million for gas on the estimates provided) should be treated as incremental to baseline expenditure. We consider that baseline capital expenditure must be determined early in the review, but it is not clear without more detail whether the forecast expenditure represents the baseline. Ofgem outlined some possible revenue drivers for incremental expenditure in the last TPCR consultation document, and energywatch hopes to provide firm thoughts on which options we prefer when Ofgem issues the next consultation.

It appears, in relation to electricity transmission in particular, that the forecasts for load-related investment have significant uncertainty and project a wide range of costs. As the price control review proceeds, we expect network operators to firm up on these forecasts, as they obtain better information about whether particular investment needs to be undertaken. We would also expect National Grid Gas to do likewise for the 'soft' projected expenditure on the gas network.

Ofgem notes that the uncertainty surrounding load-related investment arises due to the difficulty in predicting the size, timing and location of new projects. We consider that network operators should be mindful, when assessing the priority given to new projects, whether those projects are firmly established, whether they create network constraints which can be managed, and whether some projects can be advanced earlier than their position in the connections 'queue' because they provide benefits to users and consumers alike which justify 'queue jumping'. We are aware, particularly post-BETTA, that all network operators are seeking to manage connections applications on a 'first come first served' basis. However, this approach may delay other projects which, due to size, timing and location, ought to have priority but which are further down the queue. Network operators should take a flexible approach to new connections management where real benefits accrue.

We consider that the replacement of fully depreciated pre-Vesting assets needs to meet the overall tests of whether it is efficient and cost effective to do so and ensures security of supply for consumers.

Going forward, we will continue to keep these issues under review throughout the remainder of the TPCR process as and when they are raised, always considering the possible impact on consumers.

We would appreciate being kept informed of the progress of the consultation and any related issues to enable us to comment as the need arises.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley  
Head of Regulatory Affairs