



SP ENERGY NETWORKS

Duncan Innes
Head of Regulatory Reporting
OFGEM
9 Millbank
London
SW1P 3GE

Regulation

Your ref

Our Ref

OFGEM/114-08

Date

16th September 2008

Contact / Extension

Euan Norris /
01698 413914

Dear Duncan,

National Grid Electricity Transmission and National Grid Licence Amendment to include an Income Adjusting Term (Ref: 114/08)

SP Transmission (SPT) welcomes the opportunity to respond to the above consultation. We recognise that the spend that NGT is required to fund in respect of improving security for critical national infrastructure is significant over and above its normal business activities and agree that it is appropriate to consider introducing a funding mechanism in relation to this expenditure.

We have structured our response in order of the questions raised in the above consultation.

I do hope that you find this useful and should you require any additional information, please do not hesitate to contact me.

Yours sincerely

PP **Scott Mathieson**
Regulation Director
SP Energy Networks

New Alderston House, Dove Wynd, Strathclyde Business Park, Bellshill ML4 3FF
Telephone 01698 413000, Fax 01698 413053
www.scottishpower.com

National Grid Electricity Transmission and National Grid Licence Amendment to include an Income Adjusting Term (Ref: 114/08)

Chapter 1

Question 1

Do you consider the request by National Grid for an equivalent licence term to the two Scottish transmission license holders to be reasonable?

SPT believe that it is reasonable for National Grid (NG) to seek a term in each relevant licence that permits the recovery of expenditure associated with improving the security for critical national infrastructure. We note however that the term included within the two Scottish transmission license holders electricity license provides the opportunity to seek funding for expenditure already incurred and is subject to efficiency tests conducted by Ofgem at the time of application. It would therefore be reasonable to conclude that any proposed term should be applied on a similar basis and would need to be amended to incorporate any additional forecast ex-ante allowance.

Question 2

Do you consider that licensees should have to wait for up to five years before receiving recompense on expenditure incurred at the behest of government?

We consider that there is no definitive answer to this question as it is entirely dependent on the circumstances and level of expenditure that the licensee is being asked to fund. With regards to the circumstances surrounding NG's request and the extent of expenditure involved, we consider that the licensee should not be expected to fund this expenditure and wait until the end of the current transmission price review period before receiving recompense.

This conclusion has been reached based upon the high-level of expenditure that NGT is being asked to fund as a proportion of its existing allowed revenue.

Chapter 2

Question 1

Which of the “alternative treatments” do you consider the most appropriate?

In response to this question we have detailed our views on the four options considered in the consultation.

- **Logging-Up**

It is our view that the “Logging Up” mechanism is inappropriate in this case given the extensive expenditure that NG is required to fund.

- **Pass-Through**

The current pass-through mechanism permits licence holders to pass through costs that they incur as part of 3rd party bills for which they have no discretion e.g. business rates, licence fees etc. We do not consider the expenditure that NG is being asked to fund as simply pass-through as there will be an element of discretion in incurring any expenditure and would therefore discount this funding mechanism.

- **Income Adjustment**

An income adjustment term would seem the most appropriate funding mechanism to allow NG to recover costs incurred with improving security at site of critical national infrastructure. However, as mentioned previously this term is designed to allow the licensee to seek additional funding that has already been incurred and which is considered out with their control. Similarly, such costs are scrutinised by Ofgem to ensure that they have been justifiable and efficiently incurred. Some amendment from the existing provisions would be needed to deal with forward-looking costs.

- **Direct Amendment**

We think that it would be complex to derive an adjustment to the initial base revenue term determined at the last price control to reflect forecast expenditure in respect of improving security at critical national infrastructure. This is because the expenditure is unlikely to fall neatly into the opex/capex categories dealt with in ‘normal’ price reviews.

Question 2

Which of the “alternative rates of return” do you consider the most appropriate

We conclude that there is insufficient detail surrounding the type of expenditure that NG expects to incur to be able to provide a definitive view on any proposed rate of return. The very nature of the steps that NG will be taking to improve security at critical national infrastructure is most likely to lead to both capital and revenue activity.

The paper does not extend to provide adequate information on the exposure to risk that NG will have in undertaking this work at the behest of government. It would be reasonable to conclude that any perceived risk will be low, indeed it is clear that by funding this activity NG will be significantly improving their existing asset base as a consequence of government requirements.

Simply at this stage based upon the information available our view is that if it is considered that NG simply have a timing exposure during the period from which they incur costs to when they can recover those costs then a commercial cost of debt could be applied, such as Bank of England base rate +1.

Conversely, if there were a perceived risk to NG by undertaking this investment to improve security at key infrastructure on their network then it would be reasonable to expect that they should be able to earn the regulated cost of capital based upon the extent of expenditure that is transferred into the RAV. However we do not believe that all expenditure incurred will automatically be categorised as capital and that there will be an element of revenue expenditure.