Consumer Focus
Campaigning for a fair deal

Consumer Focus response to Ofgem's Transmission Price Control 4 – Scope of 'Adapted Rollover' consultation

April 2010

Introduction

Thank you for the opportunity to respond to this consultation regarding the scope of the planned one year 'adapted rollover' of transmission price control review 4 (TPCR4).

Before providing our comments on the scope of the adapted rollover we would like to express our concern about Ofgem's decision to delay the price control review. Our concerns are threefold:

1. The review may result in increased uncertainty and damage to investor confidence at a time when significant investment is required to support renewable energy
2. The proposed one year scheme is a short-term 'stop gap' to pad the period before the conclusions of RPI-X@20 can be implemented. Given the magnitude of transmission system costs, it is regrettable that we are looking at a short-term scheme developed with a lower level of scrutiny than would be the case were TPCR5 going ahead – and far from clear that it could not have been avoided
3. The majority of stakeholders' responses to the original consultation did not support the delay. We believe that many of the arguments set out in those responses were well thought through and relevant, including strong concern that the delay would result in two price controls (transmission and gas) would be operating in parallel with significant resource implications for all involved.

About us

Consumer Focus is the statutory consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland. We operate across the whole of the economy, persuading businesses, public services and policy makers to put consumers at the heart of what they do.

Consumer Focus tackles the issues that matter to consumers, and aims to give people a stronger voice.

We don't just draw attention to problems – we work with consumers and with a range of organisations to champion creative solutions that make a difference to consumers' lives.

Our response

In light of Ofgem's decision, we now provide some general comments on the scope of the adapted rollover which we hope will be given serious consideration.

Our general position for this adapted rollover is that unless the network companies are in a very poor financial position or face a major shortfall in allowed revenues we believe there is no need to make any major changes to the price control. We would prefer to see any significant changes addressed as part of the major price control review; when they can be thoroughly assessed.

It is difficult to directly compare this rollover with the last (Gas Distribution Price Control Review (GDPCR)[1] in 2007) and to predict the outcome of this rollover. However, our predecessor organisation, energywatch, in its consultation response[2] expressed strong concerns that rises in expenditure by gas distribution networks were not efficiently and economically incurred and were passed through to consumers.

As a result of the GDPCR rollover, Ofgem allowed gas distribution networks to recover £2,328 million (in 2005-06 prices) from customers in 2007-08. This represented a real increase in allowed revenue of 11.5 per cent. For the average domestic consumer, the effect on gas bills was predicted at the time to be an increase of around £10.

energywatch went on to say that any rise in costs to consumers over which they have no direct control, and whose risks they are in no position to manage, is a matter of concern.

We reiterate this concern which is even greater now at a time when all consumers, particularly vulnerable consumers, have been subjected to significant rises in energy prices and when the scope of investment required to 'decarbonise' our energy network may compound this upward pressure on costs.

We note that in Ofgem's TPCR4 final proposals (for 2007-2012) networks received generous allowances that included a 100 per cent (160 per cent for electricity) increase in allowances for capital investment relative to the previous price controls, and an increase in revenue allowances of 7.8 per cent for 07/08 followed by 2 per cent above inflation for the remainder of the price control period.[3]

TPCR4 seemed at that time, and still seems, a generous settlement for the networks – we would be anxious were it to be relaxed further. Ofgem will be in a comparatively weak bargaining position[4] with the networks on this rollover. We have strong concerns that the outcome of the adapted rollover of TPCR4 will result in unfair price increases for consumers. Given the limited time period involved we want to see Ofgem take a fairly 'light touch' approach to this adapted rollover which will hopefully result in little change for both networks and consumers.

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[1] **http://bit.ly/cVs1Rr**
[2] **http://bit.ly/ciWuIL**
[3] **http://bit.ly/cLNz6y**
[4] The threat (to networks) that a disputed scheme may be referred to the Competition Commission is likely to be much reduced for a one-year scheme compared to a five-year scheme, because the trade-off between the administrative burden of contesting the dispute versus the benefit of winning it becomes much less favourable to any regulator with a short-term scheme (indeed, it is quite possible that by the time the dispute is resolved the period covered by the price control may have lapsed). In addition to this the 'lighter touch' information gathering process envisaged by the 'Adapted Rollover' mechanism may leave the regulator less well placed to robustly defend a disputed scheme in any event.

At Ofgem's recent stakeholder workshop (on 13 April 2010) it was evident that the networks believe that significant investment, especially in the area of load related capital expenditure is required. We would want to see strong evidence that there needs to be an increase in capital expenditure for this one-year period. It is very difficult to believe that networks do not have adequate financial resources to cover this expenditure until the major price control review.

This view is especially reinforced given that Ofgem has agreed to additional investment during TPCR4 (enhanced Transmission Operator (TO) incentives announced 19 January 2010[5]) where networks will benefits from an additional £1 billion including over the period to the end of 2011/12.

We agree investment is required to allow for renewable energy targets to be met and also to decrease constraint costs which will ultimately benefit consumers, however, we need to understand why any increases to existing agreed levels of investment could not wait until the major price control review and if unavoidable that any further investment is fair and efficiently occurred.

We note that in the latest Transmission Annual Report for 2008-09[6] which reports on transmission licensee's costs and forecast capital expenditure up to end March 2009 there are a number of concerning issues:

- total controllable operating costs across the TO licensees of £319m were 15.5 per cent above allowances. As in 2007/08 this is due to National Grid Electricity Transmission (NGET) costs exceeding allowances. Internal electricity and gas System Operator (SO) costs were £91m (13.7 per cent above allowances) due to bringing a critical IT system in house
- total capital expenditure was £1034m, 4.1 per cent above allowances due to Scottish Hydro-Electric Transmission (SHETL) and NGET exceeding their load related capital expenditure allowances
- National Grid is now projecting volumes of non load related capex significantly lower than originally forecast
- National Grid forecast SO internal capex significantly exceed (32.9 per cent) the allowance due to upgrading critical systems
- all incurred lower interest costs than envisaged

It appears to us that, despite a generous settlement, transmission network operators may not be operating as efficiently as they could be, with significant operating costs above allowances. If, as part of this adapted rollover, networks are permitted to increased allowed revenues to cover any inefficiencies this would be extremely unfair for consumers.

Also it would be useful to know where costs are now predicted to be significantly less than originally expected that consumers will realise the benefit of this.

We also note with concern that capital expenditure was 4.1 per cent above allowances. Networks imply that more capital expenditure is required beyond existing levels and we believe that this needs to be properly assessed as part of the major price control review not as part of this proposed high level review.

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[5] **http://bit.ly/caG1mn**
[6] **http://bit.ly/cs3Z4k**

On another issue, we would also like Ofgem to look at the interaction between this price control and the SO incentives scheme particularly with regard to constraints.

TO incentives and SO incentives essentially look at separate sides of the same coin: the former looking at what you build; and the second at how you use it. The outcome reached in one scheme may influence the other.

We note in Ofgem's final proposals consultation document on SO incentives that a longer term scheme would be moving towards alignment with the transmission price controls from 1 April 2012. It was noted that there are potential benefits to be gained in respect of NGET and National Grid Gas (NGG) being able to make SO decisions based on compatible incentives provided by the TO price controls[7]. We need to be reassured that the price control and SO incentives are not sending out perverse or conflicting signals.

In conclusion, we believe Ofgem should protect the interests of existing and future consumers by ensuring that the scope of this adapted rollover is proportionate for a one year control and therefore recommend a 'light touch' approach. As we have previously stated unless the network companies are in a very poor financial position or face a major shortfall in allowed revenues we believe there is no need to make any major changes to the price control. We would prefer to see any significant changes addressed as part of the major price control review; when they can be thoroughly assessed.

[7] **http://bit.ly/9jyj7w**

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