Promoting choice and value for all gas and electricity customers

Reference: **129/11**
Direct Dial: 020 7901 7165
Email: Gareth.Walsh@ofgem.gov.uk

Date: 7 October 2011

Dear Colleague,

Transmission Price Control Review 4 (TPCR4) rollover supplementary consultation

Following the publication of our initial proposals for the TPCR4 rollover we have identified the need to grant an ex-ante allowance for two additional cost categories. These categories are:

- An operating expenditure allowance for system operation costs associated with the offshore network for National Grid Electricity Transmission plc (NGET).
- A capital expenditure allowance to fund pre-construction works for a number of projects by Scottish Hydro Electric Transmission Limited (SHETL).

This letter provides a brief background to the price control before outlining the detail of our proposals on each of the items referenced above. Additionally, based on discussions following the publication of our Initial Proposals, we are proposing to allow National Grid Gas plc (NGG) costs associated with quarry and loss development to continue to log up during the rollover year. This letter explains our rationale and again we invite stakeholders to comment.

We invite stakeholders to comment on the proposed approach and request that responses be submitted by midday on **Friday 28 October**. We appreciate that this is an abbreviated consultation period and invite stakeholders to request additional time should it be required. We request all responses be submitted via email to the following address: TPCR4.Rollover@ofgem.gov.uk

Background to the TPCR4 rollover and reason for this consultation letter

The current gas and electricity transmission price control (TPCR4) expires on 31 March 2012. To enable the next price control to reflect fully the new RIIO model for regulation, we previously announced our decision to delay implementation of the new price control until 1 April 2013. We will therefore implement a one-year rollover (known as the TPCR4 rollover) of the existing price control to operate in the period 1 April 2012 to 31 March 2013. In August, we published our Initial Proposals for the TPCR4 rollover, in which we outlined our proposed operational and capital allowances, along with the policy framework. Since issuing our Initial Proposals, we have identified a number of additional areas on which we wish to seek stakeholder input. The remainder of this letter consults further on these issues.

Funding NGET for operational expenditure associated with the development of the offshore transmission regime

When setting the TPCR4 price control, NGET were not granted an allowance for costs associated with the development and delivery of the offshore transmission regime. In 2007, we set out that, rather than include an allowance for these costs, we would require NGET to record these costs in detail and report them to us[1]. In 2009 we decided to allow such costs, where efficiently incurred, to be passed through to consumers[2]. Costs that have been passed through in this manner to date are detailed below:

	2007/08	2008/09	2009/10	2010/11
Total Actual Spend	£0.8m	£0.5m	£1.5m	£2.2m[3]

Table 1: SO opex associated with the offshore network passed through to consumers

We consider it appropriate to transition the funding arrangements for these costs to an ex-ante allowance. This is in line with the arrangements for internal operational costs incurred balancing the onshore network. In common with other operational costs associated with system operation this ex-ante allowance will be subject to a 25% sharing factor, through which NGET will be exposed to 25% of the cost / benefit of any over / under spend against the allowance. This should provide a greater incentive for NGET to incur these costs efficiently. According to NGET's forecast business plan for 2012/13, they expect these costs to total **£2.3m**. We propose that the allowance should be set slightly lower at **£2.0m**. This is the average of the forecasted costs from 2010/11 to 2012/13 contained within their RIIO-T1 forecasts.

Question 1: We invite stakeholders to comment on our proposed approach and allowance.

[1] http://www.ofgem.gov.uk/Licensing/Work/Notices/ModNotice/Documents1/17094-3507.pdf
[2] http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/cons2009/Documents1/AA5A%20letter%20FINAL.pdf
[3] National Grid are requesting this as a revenue adjustment, however this is currently awaiting approval from the Authority.

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Funding SHETL for pre-construction works on a number of projects that were not included in our initial proposals for the rollover

SHETL are currently developing a range of transmission investment projects, and have requested pre-construction funding for a number of these projects in the rollover year. These projects are similar in nature to those considered in the context of our Transmission Investment Incentives (TII) work-stream, and funding for the rollover year was not included in our initial proposals. These projects are listed below:

Beauly - Blackhillock 275kV	Beauly - Tomatin
Orkney West HVDC	Knocknagael - Foyers
Dounreay - Mybster 275kV	Taynuilt - Inveraray
Peterhead - Rothienorman 400kV Upgrade	Inverary - Crossaig
Peterhead 400kV Busbars	Beatrice
Orkney West 132kV	Fort Augustas - Fort William
Blackhillock - Kintore 275kV reconductoring - Design	Dounreay radials - Design
Beauly - Cambusmore 275kV - Design	Alness s/s – Design
400 kV East coast upgrade - Design	Cambusmore s/s - Design
Kintyre (Hunterston / Crossaig subsea crossing) - Design	

Table 2: Projects for which pre-construction funding was not included in SHETL's capex allowance in our initial proposals

In total SHETL are proposing to spend **£8m** on these projects in the rollover year. These projects have not to date received funding through either the TPCR4 price control or our TII work-stream. Having considered the most appropriate mechanism through which to fund these projects we propose to incorporate an ex-ante allowance to fund these works into the rollover baseline capital expenditure (capex) allowance. As with other elements of the ex-ante capex allowance this will be subject to a 25% sharing factor, through which SHETL will be exposed to 25% of the cost / benefit of any over / under spend against the allowance.

We propose to grant an ex-ante allowance in line with SHETL's request of **£8m**. In most cases the costs for the individual schemes are minimal (<£0.5m). Where the proposed expenditure is material we have engaged with SHETL and are satisfied their projected costs are reasonable and efficient. Additionally, allowances granted as part of the rollover will be considered when assessing any further requests for construction or further pre-construction funding for these projects as part of the RIIO control.

Question 2: We invite stakeholders to comment on our proposed approach and allowance.

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Allowing NGG to continue to log up costs associated with quarry and loss development

In setting the TPCR4 price control, we allowed the licensees to log up costs in a specific number of categories. We applied this approach to costs where there was a significant amount of uncertainty as it avoided us having to project these costs in advance. In order to protect consumers from inefficient spend these logged up costs will be subject to a full ex-post efficiency at the end of the current price control[4]. In setting the rollover price control, we considered the level of uncertainty to be limited for a one-year period, and proposed that we do not continue to allow costs to log up during 2012/13.

We maintain this view for the majority of cost categories, however, after further consideration, we consider it appropriate to continue to allow NGG to log up costs associated with claims and compensation for loss of land use due to the installation of Gas Transmission pipelines. These costs are uncertain, and setting an ex-ante allowance would expose NGG to potential gains or losses due to events outside of their control. To protect consumers from inefficient spend in this area NGG will continue to have a licence obligation to challenge as far as is reasonable these claims, and revenue will only be awarded to recompense these costs following a full efficiency review.

Question 3: We invite stakeholders to comment on our proposed approach.

If you wish to discuss any of the issues associated with this consultation please do not hesitate to contact me on 0207 901 1867 or Gareth.Walsh@ofgem.gov.uk. We invite stakeholders to comment on the proposed approach and request that responses be submitted by midday **on Friday 28 October**.

Yours sincerely

Gareth Walsh

Senior Manager, Electricity Transmission Policy

[4] As communicated in our initial proposals efficient investment will enter the RAV on 1 April 2013. http://www.ofgem.gov.uk/Networks/Trans/PriceControls/TPCR4Roll-over/Documents1/110802TPCR4RolloverIP.pdf