

Ofgem Analysts' Presentation

On 27 September Ofgem published its update on the Distribution Price Control Review proposals. An analysts' conference was held. It was introduced by Ofgem's Chief Executive Alistair Buchanan, Managing Director for Networks, and was hosted by Managing Director for Networks, David Gray, and Director for Electricity Distribution, Martin Crouch. The accompanying slides are attached.

A recording of the conference is available. If you wish to listen, please dial +44 (0) 208 515 2499 and enter PIN 610442#. All documents are available on the Ofgem website.

The recording will be available until 30 September.

The final proposals will be published on Monday 29 November.



Electricity Distribution Price Control Review

Update paper

September 2004

Analyst presentation

What's in this update?

- Updates on allowances, targets and revenues
 - Analysis of more recent data
 - Further consideration of company arguments
- Significant changes on pensions and tax; revisions to Regulatory Asset Value (RAV) calculation
- **On average, distribution charges broadly flat in real terms; some increases and some reductions**

Timetable

- September 2004: publication of Update Document
- October 2004: bilateral meetings with DNOs/interested parties
- **November 2004: final proposals**
- December 2004: companies decide to accept/reject proposals
- Early 2005: for each company:
 - licence modifications or
 - Competition Commission referral
- April 2005: new price controls implemented

Operating costs

- No change in approach to regressions:
 - upper quartile benchmark
 - no general glidepath beyond 2005
 - scale variable 50% weighted to network length
 - take account of merged groups and total costs
- Regional factors still under consideration
- 2003/04 costs higher than 2002/03, but differences can be explained
- Increased allowances for tree-cutting, exceptional events and quality improvements (additional £21m/year relative to June)
- **Benchmark costs to reduce by 1.5% per annum from 2005/06**
- **Total controllable costs of £755m (up from £702m)**

Average opex allowances 2005-2010

DNO	September 2004 Update	Difference to June Initial Proposals	Difference to DNO Adjusted DPCR4 Forecast
	£m	£m	£m
CN - Midlands	59	4	(6)
CN - East Midlands	64	4	4
United Utilities	55	3	(17)
CE - NEDL	43	3	1
CE - YEDL	52	5	(0)
WPD - South West	48	3	(7)
WPD - South Wales	40	3	4
EDF - LPN	51	3	(21)
EDF - SPN	50	3	(17)
EDF - EPN	83	7	(17)
SP Distribution	56	4	1
SP Manweb	47	4	5
SSE - Hydro	38	2	(1)
SSE - Southern	68	4	2
Total	755	53	(70)

Note: All differences subject to rounding

Capital expenditure

- Review of future capex
 - Ofgem and PB Power have met with companies to discuss Initial Proposals
 - Net change of +£182m on capex allowances
- Confirm sliding scale incentives
 - Equalise incentives for opex and capex pending improvements in cost reporting

Total capex allowances 2005 - 2010

DNO	September 2004 Update	Difference to June Initial Proposals	Difference to DNO Adjusted base case Forecast
	£m	£m	£m
CN - Midlands	477	2	(8)
CN - East Midlands	476	26	(4)
United Utilities	466	5	9
CE - NEDL	277	11	9
CE - YEDL	367	38	8
WPD - South West	283	19	13
WPD - South Wales	179	8	8
EDF - LPN	454	15	(89)
EDF - SPN	468	(2)	(21)
EDF - EPN	701	26	(156)
SP Distribution	367	(3)	(28)
SP Manweb	406	13	(59)
SSE - Hydro	204	10	(5)
SSE - Southern	536	13	25
Total	5,661	182	(295)

Note: All differences subject to rounding

Quality of supply

- Minor changes to targets for interruptions
- Changes to cost allowances for improvements in quality of supply and exceptional events (+ £11m capex, + £39m opex in total over 5 years)
- Clarifies treatment of exceptional events
 - Very large severe weather events
 - One-off events such as vandalism

Financial issues

- Base revenue
- Pension costs
- Taxation costs
- RAV roll-forward
- Financial ratios and depreciation
- Cost of capital – final point estimate will be given in November
 - No compelling evidence to alter view given in Initial Proposals

Revenue

- Companies asked to re-forecast 2004/05 revenues
- Generally, forecasts higher than in June so P0 values lower (smaller increases, larger reductions)
 - Especially for Manweb
- Also examined excluded services revenue in more detail
 - Removed elements relating to metering and NGC exit charges
 - Lower assumed excluded services revenue for 2005-10 than in June implies higher price control revenue, higher P0

Pension costs

- Allocate 80 per cent of assets and liabilities to distribution
 - EPN, YEDL allocated 100 per cent
 - Scottish company schemes not in deficit
- Allowance made for 70 per cent of deficits relating to Early Retirement Deficiency Contributions
- Pension allowances allocated to opex or capex in line with average accounting treatment
- Increase in allowances of +£70m and significant reduction of risk

Taxation

- End of non-load agreement will lead to higher tax charges
- Scope for companies to re-optmise tax position
- Price controls based on average accounting treatment
- Additional allowances + £89m relative to June
- Any efficiencies shared with customers

RAV roll-forward

- Detailed discussions with companies following June paper
- Difficulties relating to changes in accounting approach during DPCR3
 - faults
 - overheads
- Results in industry-wide RAV similar to June, but some differences across companies
- Uncertainty over RAV unhelpful – propose to utilise new cost reporting framework to track RAV annually in future

Revenue and P_0 changes (with $X = 0$)

DNOs	June Initial proposals	September Update	Difference
	%	%	%
CN - Midlands	-6%	-5%	2%
CN - East Midlands	-11%	-8%	3%
Unitied Utilities	-2%	6%	7%
CE - NEDL	-11%	-3%	8%
CE - YEDL	-15%	-13%	2%
WPD-South West	0%	2%	2%
WPD-South Wales	2%	7%	6%
EDF - LPN	-2%	-4%	-2%
EDF - SPN	-4%	3%	7%
EDF - EPN	-5%	-2%	2%
SP Distribution	8%	11%	2%
SP Manweb	4%	-6%	-10%
SSE - Hydro	0%	3%	3%
SSE - Southern	6%	9%	3%
Total	-2%	0%	2%

Note: All differences subject to rounding

Average Revenue Allowances 2005-10

DNOs	June Initial proposals	September Update	Increase
	£m	£m	£m
CN - Midlands	227	241	15
CN - East Midlands	229	245	16
Unitied Utilities	201	220	19
CE - NEDL	140	159	18
CE - YEDL	187	197	11
WPD-South West	170	180	10
WPD-South Wales	136	148	12
EDF - LPN	224	227	4
EDF - SPN	150	166	16
EDF - EPN	279	289	11
SP Distribution	284	292	8
SP Manweb	169	176	7
SSE - Hydro	157	169	12
SSE - Southern	328	341	13
Total	2880	3050	170

Note: All differences subject to rounding

Conclusions

- Update paper addresses issues raised by respondents on:
 - Opex
 - Capex
 - Pensions
 - Tax
 - RAV
- Issues remaining for final proposals
 - Cost of capital
 - Some company-specific issues
- Responses to update paper welcome on or before 25 October



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