VALUATION OFFICE AGENCY and SCOTTISH ASSESSORS ASSOCIATION

RESPONSE TO THE GAS DISTRIBUTION PRICE CONTROL REVIEW INITIAL CONSULTATION

PASS THROUGH AND NON-DOMESTIC RATES

<u>Background</u>

1. Rates are a tax on property. The "full" rates bill is the product of the rateable value for the property and the rate poundage for the year. The bill may also vary with transitional arrangements which phase in big changes in liability in England and Scotland.

2. The rate poundages and, where appropriate, the transition schemes are set by the respective Governments for England, Wales and Scotland. The rateable values are set independently by the Valuation Office Agency (for England and Wales) and Scottish Assessors (for Scotland) and are subject to appeal – this is called "conventional assessment".

3. Prior to 1 April 2005, the rateable values of the gas network were in "prescribed assessment". Under this system, officials in the then Department of Environment Transport and the Regions (DETR), the National Assembly for Wales (NAW) and the Scottish Executive (SE), assisted by the Valuation Office Agency and Scottish Assessors, discussed draft rateable values with Transco before Ministers made a decision and prescribed the figures by statutory instrument. Ownership of the exercise rested with DETR, NAW and SE and the companies had no right of appeal.

4. A revaluation of all rateable values takes place every 5 years. At the last revaluation (from 1 April 2005), all 3 Governments decided to end prescribed assessment. As a result, the rateable values of the gas networks were assessed independently by the Valuation Office Agency and the Scottish Assessors using conventional techniques. The occupiers have full rights of appeal.

<u>The revaluation process</u>

5. Broadly speaking, the 2005 rateable values are based on the annual rental value of the properties at 1 April 2003. For utilities we assess the rateable value using a receipts and expenditure method of valuation. This is a form of Discounted Cash Flow valuation but adapted to conform with the rating world and to share the value between the landlord and the tenant. The landlord's share is the annual rent and, therefore, the rateable value.

6. Whilst we completed a single valuation for the entire gas network, this valuation was built up from each of Transco's business units and, therefore, was capable of being split with ease into

separate valuations for meters (separately assessed in England and Wales from 1 April 2005) and the Distribution Networks sold outside the National Grid Group (separately assessed from 1 June 2005).

7. Compiling the valuation was a detailed and comprehensive exercise. We met Transco (now National Grid) and their advisors on 8 occasions between August 2002 and May 2004 and inspected various gas sites. Throughout the exercise, Transco co-operated fully and met all of our information requests providing detailed information on the assets, capital and operating costs of their business. The valuation was also a joint exercise between all parties. We always explained our approach to Transco and they often challenged us on our positions and always offered alternatives. As a result, the valuation progressed through several versions and comprises elements originally suggested by all parties including Transco. The outcome was, therefore, a fully developed and considered valuation of the gas network, although it has not been agreed with Transco.

8. Following the sale of some of the Distribution Networks in June 2005, the newly independent gas distribution networks were split from the main Transco assessment. At that time, we sent to each of the new operators a copy of their valuation and an explanation.

<u>Interaction with the price review</u>

9. Paragraph 6.10 of the consultation paper seeks views on which costs should be subject to pass through. Currently, network non-domestic rates are treated as a pass through in the price control. This, we understand, was due in part to those rates prior to 2005 being prescribed with no right of appeal. Whilst, prescription has now ended and the companies have full rights of appeal against their rateable value, the rates bill is still a largely uncontrollable item. This is because:

- the poundage and the transition schemes are key elements in the rates bill and are set by the Governments. They are entirely outside the control of the companies,
- the rateable value is set by the Valuation Office Agency or the Scottish Assessors as appropriate in line with a statutory hypothesis – the companies may only exert an influence upon the value to the extent that it can be shown to be wrong. The companies can appeal but if, in court, we can illustrate that our valuation complies with the statutory hypothesis then the appeal will fail, and
- the companies cannot rationalise their network to reduce the network rates bill (in contrast to rates on non-network property which has always been assessed separately from the network and fallen outside the pass through).

10. This is especially true in light of our approach to the 2005 valuation. Our policy at the 2005 revaluation was to have rateable values “right first time”. As a result, we have used the 18 months of work on the valuation to build up the detail, identify the central issues and then, where appropriate, adopt realistic but conservative positions in the valuation. The result is a valuation which we believe to

be defensible. We would welcome the opportunity to explain our valuations to Ofgem and illustrate their defensive nature (although this would require the consent of the ratepayers).

11. Finally, we note that Ofgem considered these issues in the price review for the Electricity Distribution Network Operators (who like Transco were moved to conventional rating in 2005) and decided to retain the pass through for network rates.

12. In view of the above, we believe that network rates should continue to be treated as a pass through item in the next gas distribution price review.

5 January 2005