Ofgem Price Control Reviews

Analyst Presentation – 4 December 2006

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Disclaimer: The information contained in these slides is a summary of the initial proposals for the transmission price control. Full details of GEMA's proposals for the price controls are set out in the publications "Transmission Price Control Review: Final Proposals" and "Gas Distribution Price Control Review One Year Control Final Proposals". The information contained in these slides is intended to summarise some aspects of the key features of the proposals but neither GEMA nor Ofgem represent or warrant that the information contained in these slides constitutes an accurate or complete summary of the initial proposals.

Transmission Price Control Review
Final Proposals

Note: All figures quoted are in £m 04-05 real, unless otherwise stated

Transmission Price Control - Highlights

- Increased opex & capex since September Update
- +2% on revenues since September, +8% against 2006/07 allowances
- Revenues profiled to increase throughout period
  - Better match with expenditure
- Cost of capital set at 4.4% real post-tax
- New capex "safety net" mechanism

Capex allowances

£m 04/05	NGGT	NGET	SPTL	SHETL	Total
Previous 5 year control allowance	889	1453	152	71	2565
Final Proposals	824	2997	608	181	4609
Change from previous control	-65	+1544	+456	+110	+2044
	-7%	+106%	+300%	+155%	+80%
Change since Updated proposals	+27	+43	+32	+3	+106

Investment

- Historic
  - St. Fergus – 25% disallowance of £75m project
- Future
  - Load related expenditure
    - Baseline allowances
    - Revenue drivers
  - Safety net if investment falls 20% below allowance
- Increased investment means higher transmission charges

Revenue profiling

- Electricity revenues have been profiled to increase at 2% above RPI because:
  - Better matching of revenues with increasing capex requirements
  - Benefits financial ratios over period
  - Results in a smaller step change in revenues in the following price control period
- Gas revenues on flat profile throughout period (ie X = 0)
  - Not subject to the same increase in capex requirements

Cost of Capital

- Vanilla WACC set at 5.05% real (equivalent to 4.4% real post-tax)
- Consistent with
  - Cost of debt 3.75% (Risk free rate 2.5%, Debt premium 1.25%)
  - Cost of equity 7.0%
  - Gearing 60%
- Scottish companies will need to input equity under medium/high capex scenarios in order to maintain ratios
  - Ex ante provision for equity issuance costs, with ex post true-up
  - £1m for SPTL/£5m for SHETL

Revenue calculations

- Annual average revenue allowances (comparable to Update proposals)

£m 04/05	NGGT	NGET	SPTL	SHETL	Total
2006/7 Allowance	442	1,005	160	51	1,657
September Update	472	1,076	149	49	1,747
Final Proposals	489	1,093	156	50	1,788
Change from Update	16	17	7	1	41

- Po and X proposals after revenue profiling

	NGGT	NGET	SPTL	SHETL	Total
Po	17%	7%	-5%	-5%	8%
X	0%	2%	2%	2%	-

RAV roll-forward

£m 04/05 real	NGET	NGGT	SPTL	SHETL
Opening RAV*	5113	2328	681	247
Depreciation	2380	424	424	113
Additions	2683	1077	507	154
Closing RAV end 06/07	5416	2981	764	288

* 1999 for SPTL & SHETL, 2000 for NGET, 2002 for NGGT. Additions include expenditure since base dates, BETTA transfers and other adjustments

Future issues

- Regulatory reporting for greater transparency between review periods
- Output measures for network performance monitoring
- Island links
- Gas network planning
- User commitment reforms

Gas Distribution Price Control Review
One Year Control Final Proposals

Note: All figures quoted are in £m 05-06 real, unless otherwise stated

Minor movements since initial proposals

- No change on main aspects of policy
- There have been minor movements in our position since initial proposals reflecting:
  - a continuing active dialogue with the companies
  - audited actual accounting information for 2005-06
  - results of actuarial reviews for SGN and WWU pension schemes
  - latest information on gas prices and forecast throughput for 2007-08
- Final proposals give rise to P0 increase of 11.5 per cent compared to 9.7 per cent under initial proposals

One year control overview

Final proposals - 2007-08 allowed revenue by GDN

GDN		2007-08 allowed revenue	Year on year change (P0)
NGG	East England	427.2	12.4%
	London	245.1	9.9%
	North West	285.5	10.6%
	West Midlands	217.8	11.0%
NGN	North England	273.5	8.7%
SGN	Scotland	194.3	12.9%
	South England	432.4	13.0%
WWU	Wales & West	252.0	12.9%
Total		**2,327.7**	**11.5%**

Historical capex and repex assessment

- We have completed our detailed review of historical spend
  - analysis has been updated to reflect new information, but we have not changed our position on the treatment of spend
- Changes since initial proposals add £45m to GDNs' opening RAVs as at 1 April 2007
- GDNs' shareholders fund 37 per cent of the overspend

RAV roll forward

RAV roll forward (total all GDNs)

	2002-03	2003-04	2004-05	2005-06	2006-07
Opening value bf per last price control	10,634.7				
Additions to pre-2002 assets	91.8				
Revised Opening value bf	10,726.5	10,845.7	10,845.7	10,815.5	10,799.1
Depreciation	-376.4	-380.7	-382.4	-383.5	-384.9
Net capex additions	507.0	379.4	351.5	371.6	380.4
Disposals	-11.4	1.2	0.8	-4.5	-3.5
Closing RAV (incl. Pot 3)	10,845.7	10,845.7	10,815.5	10,799.1	10,791.2
Pot 2 additions (cumulative)	63.4	151.4	247.6	444.5	660.1
Pot 2 depreciation (cumulative)	0.0	-1.4	-4.8	-10.3	-20.2
Total Closing RAV	**10,909.1**	**10,995.6**	**11,058.3**	**11,233.3**	**11,431.2**

Other issues addressed as part of one year control

- Higher shrinkage, pensions allowances reflecting higher costs
  - plus new methods for setting allowances that reduces risk to GDNs
- Reduced tax allowances reflecting GDNs' actual tax costs
  - we have set a company specific ex ante tax allowance

- We have **not** reviewed the cost of capital
  - existing cost of capital rolled over but converted to a post-tax figure
  - 4.38% post-tax WACC, equivalent to 6.25% pre-tax, vanilla WACC 5.25%

We will consider the cost of capital to apply to gas distribution next year

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