

## Transmission Annual Report for 2006-07

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**Target Audience:** This document may be of particular interest to users of the transmission networks, licensees, providers of finance, consumer groups and other interested parties.

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### **Overview:**

This report sets out operating cost and capital expenditure data for the four licensees in respect of their transmission ownership (TOs) for the year ended 31 March 2007. It also shows Ofgem's provisional assessment of Regulatory Asset Value (RAV) for each licensee as at 31 March 2007. The RAV will be finalised at the next price review following an efficiency assessment.

This is the first annual report on transmission licensees costs and forecast capital expenditure based on the regulatory reporting process introduced as part of Transmission Price Control Review for 2007-12 (TPCR4).

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## Context

All transmission licensees are required to report annually to Ofgem on the costs they incur in operating, maintaining and improving their transmission systems. Over time this information will show the trend of expenditure on each transmission system and inform the next transmission price control review, TPCR5.

We are committed to publishing an annual report on cost data. This report is the first of its kind following the transmission price control review and covers the year before the price control period.

The aim of the report is to present the key information on the licencees operating and capital costs in a meaningful and user friendly format.

## Associated Documents

The following documents may be found on our website:

[http://ofgem2.ulcc.ac.uk/temp/ofgem/cache/cmsattach/17916\\_20061201\\_TPCR\\_Final\\_Proposals\\_in\\_v71\\_6\\_Final.pdf?wtfrom=/ofgem/whats-new/archive.jsp](http://ofgem2.ulcc.ac.uk/temp/ofgem/cache/cmsattach/17916_20061201_TPCR_Final_Proposals_in_v71_6_Final.pdf?wtfrom=/ofgem/whats-new/archive.jsp)

- TPCR 2007 - 2012 Final Proposals, December 2006 (ref 206/06)

## Table of Contents

<b>Summary</b> .....	<b>1</b>
The purpose of the review .....	1
Results for 2006/07 .....	1
<b>1. Overview of the process</b> .....	<b>2</b>
Introduction .....	2
Objectives .....	3
The regulatory reporting process .....	3
Lessons learned from the 2006/7 trial year .....	3
Compliance .....	4
<b>2. Review of Performance (in 2006/07 prices)</b> .....	<b>5</b>
Background .....	5
Operating Costs for 2006/07 .....	6
Capital Costs for 2006/07 .....	6
Forecast Capex for TPCR5 .....	7
Provisional RAV .....	8
Capitalisation Items .....	10
<b>3. Data on individual transmission licensees</b> .....	<b>12</b>
National Grid Gas (NGG) .....	12
LICENSEE'S COMMENTS .....	14
National Grid Electricity Transmission (NGET) .....	15
LICENSEE'S COMMENTS .....	16
Scottish Power Transmission (SPT) .....	17
LICENSEE'S COMMENTS .....	18
Scottish Hydro Electricity Transmission (SHETL) .....	19
LICENSEES COMMENTS .....	20
<b>4. Amendments to Regulatory Reporting Pack (RRP) Tables</b> .....	<b>22</b>
<b>Appendices</b> .....	<b>24</b>
<b>Appendix 1 - Responses and Questions</b> .....	<b>25</b>
<b>Appendix 2 - The Authority's Powers and Duties</b> .....	<b>26</b>
<b>Appendix 3 - Glossary</b> .....	<b>28</b>
<b>Appendix 4 - Feedback Questionnaire</b> .....	<b>29</b>

## Summary

### The purpose of the review

The last transmission price control review (TPCR4) set out the importance of capturing historical data consistently on an annual basis. We have therefore committed to annual cost reporting. This will improve the quality of our information on cost, revenue, incentive and output reporting and will help us to monitor and set future price controls and incentives. The process also enables an understanding of the costs and underlying policies of the electricity transmission owners (TO's). The work enables comparison of actual expenditure to the price control allowances set at TPCR4 and aims to inform the next price control (TPCR5).

By reviewing costs on an annual basis as TPCR4 progresses and setting provisional regulatory asset values we provide a solid foundation on which we have built our knowledge and on which policies will be developed for TPCR5. These reviews will reduce the amount of work required examining these areas at TPCR5 and mitigate the problem of inconsistency in reported historic data.

The basis for the reporting of costs is set out in the Transmission Price Control Review Cost Reporting Rules; Instructions and Guidance (version 1.0) March 2007. These rules were developed following the last price control to provide a robust and coherent framework for cost reporting in the format of a Regulatory Reporting Pack (RRP). The pack comprises formatted Excel workbooks and a commentary on annual expenditure.

The report also gives a greater degree of transparency in respect of performance versus allowances and our aim is to simplify the reports so that they are accessible to a wider audience. In particular it shows the need to be aware of timing differences between when actual costs and investments are incurred and consequential regulatory allowances 'kick-in' (eg for logged up costs and incremental investment revenue drivers). Consequently it highlights that in addition to the provisional regulatory asset value (RAV) there is also additional capital expenditure (which will have been financed). Consequently gearing ratios need to be viewed in the light of such timing issues.

### Results for 2006/07

Total industry controllable operating costs in 2006/07 increased from £274m to £305m, not dissimilar to the £297m predicted in TPCR4 for 2007/08 the first year of the price control (all in 2006/07 prices).

Total industry capital expenditure entering the provisional RAV was £1,116m some £54m lower than anticipated by Ofgem in TPCR4 and over 10% lower than the £1,242 indicated by the licensees at that time.

## 1. Overview of the process

### Chapter Summary

This is the first and trial year of the Regulatory Reporting process introduced as part of the last transmission price control settlement.

### Questions

- Question 1: Do you agree with publishing information on each licensee?
- Question 2: Do you agree with each licensee providing a narrative?

### Introduction

1.1. In the Transmission Price Control Review Final Proposals (Ref 206/06) published in December 2006 paragraph 12.1 we indicated:

*"In previous consultations we have indicated we intended to adopt the approach initiated in DPCR4 and introduce an annual regulatory reporting pack. The licensees and credit rating agencies have generally welcomed this approach. This will improve the quality of our information on cost, revenue, incentive and output reporting and will help us to monitor performance and set future price controls and incentives. We expect the licensees to provide accurate, complete and timely information and we will routinely publish this information."*

1.2. Following TPCR4 new license conditions (B16 and A40 for gas and electricity respectively) were introduced to provide for an annual reporting process.

1.3. Regulatory reporting has now been running for three years in Electricity Distribution and we have sought to take advantage of this experience in our approach. In addition we have requested the licensees supply a relevant commentary to go with their data.

1.4. This first report (for 2006/7) is for the year preceding the current price control period and essentially represents a trial year for our regulatory reporting process for the four licensees only in respect of their transmission ownership (ie and not in respect of system operation) . These are:-

- National Grid Gas (NGG),
- National Grid Electricity Transmission (NGET),
- Scottish Power Transmission (SPT), and
- Scottish Hydro Electric Transmission limited (SHETL).

## Objectives

1.5. Our consultation last year provided a format and the rules and guidance for the provision of data by the licensees to the Authority. The objectives of the rules are to:

- ensure the RAV is rolled forward according to the TPCR4 Final Proposals;
- improve the robustness and consistency of data reported to us;
- reduce the burden on TO's to provide such information at a price control; and
- improve the transparency of reporting requirements.

## The regulatory reporting process

1.6. The key elements of the annual reporting process are to provide an overview of:

- operating costs,
- capital expenditure,
- a provisional RAV.

1.7. The provisional RAV is calculated in accordance with our methodology set out in the TPCR4 Final Proposals, this RAV is (as in Distribution) "provisional" until finalised at the next price control. However, in transmission, we will be undertaking an efficiency assessment of historic expenditure at the next price review.

1.8. The process followed in this trial year for the RRP had, at their request, provided a derogation to the licensees of an additional two months (to 30th September) to supply the operating costs and financial data. The review included two visits to the licensees, the first to clarify some data submitted and the second with the Director of Transmission to review the results. Overall, the response from licensees to this process has been constructive.

## Lessons learned from the 2006/7 trial year

1.9. It is proposed to make some changes to the reporting process for future years:

- to enable the external report for publication to be prepared earlier than this year, we will not provide a derogation,
- to validate the licensees income for the first time in transmission a revenue reporting section is being added for 2007/08 onwards,
- System Operator (SO) costs will be included in the published report next year,
- to specifically meet the request by the licensees to avoid excessive workload on key individuals, which could otherwise impact on the quality of the submission, we will provide a gap of a fortnight between transmission and distribution for the completion of submissions and visits to licensees, and
- to reduce clarification questions and save time we will include within the RRP extra comparison tables and questions for their narrative and on forecast capex the impact of specific cost inflation and the volume of asset replacement.

## Compliance

1.10. We take compliance with license conditions very seriously. We expect licensees to augment their processes and systems where necessary, to collect, reconcile and supervise data so as to complete reporting to us in accordance with the guidance. There is a licence requirement for licensees to come forward with any errors that have occurred in previous submissions and, where inadvertent, we have not penalised them for these.

1.11. During this trial year we have also validated, to our satisfaction, substantive samples of the data submitted by the licensees in the reports to us.

## 2. Review of Performance (in 2006/07 prices)

### Chapter Summary

During the year licensees have in aggregate spent in excess of the levels indicated in their price controls on both operating costs by 10% (£507m v ££461m) and on general capital expenditure by 7% (£764m v £716m) noting the other significant capital expenditure of £428m.

### Questions

- ➔ **Question 1: Would extra detail on operating costs be of any value?**
- ➔ **Question 2: Do you agree with providing an income summary next year?**

## Background

2.1. In this section we have provided an overview of the main components for licensees expenditure on costs in 2006/07 compared to the equivalent data in their respective price controls with those values converted to this years' price level:

- Operating Costs in 2006/07,
- Capital Expenditure in 2006/07,
- Forecast Capex for 2007/12, and
- Provisional RAV for 2006/07.

2.2. This was the year before the TPCR4 price control period of 2007-12 and also the last year of the previous controls. Previously it would only be reviewed as part of the next price control review some 5 years later. We have not reviewed the System Operator (SO) form of control in depth this year but intend to do so in future years.

2.3. In the Tables we have provided overall totals on electricity for the three licences, gas has one licensee, there are differences in the elements for gas and electricity. For NGET, 2006/7 was a one year price control extension, for SPT and SHETL it was the second year of a 2 year extension, and for NGG it was the final year of the 2002-7 price control period and in which gas figures were split between distribution and transmission to facilitate the sale of some gas distribution regions. We have therefore made comparisons between:-

- Actual outturns for 2006/7, and the allowances or forecast values used in the relevant preceding price control Final Proposals i.e. showing licensee performance against the previous price control allowances;
- Actual outturns for 2006/7, and the 2006/7 forecasts made by Licensees for use in TPCR4 i.e. showing the variance between the licensee forecast during 2006 and the end of that financial year; and
- Actual outturns for 2006/7, and the values used by Ofgem in TPCR4 Final Proposals showing movement versus TPCR4 first year predictions.

## Operating Costs for 2006/07

2.4. Table 2.1 below shows total outturn operating costs (non-controllable and controllable) compared to allowances. It indicates that overall for controllable costs NGG & NGET have overspent by £38.7m or 16% and that SPT overspent by 21% and SHETL underspent by 11%. The primary reason for overspend versus allowance was the level of expenditure on non operational capex (which is treated as opex).

2.5. Where non-controllable costs consisting of transmission such as network rates, and where relevant license fees to the Authority, exceed allowances these variations are (as cost pass-through terms) collected or repaid in revenue the following year.

Table 2.1 Opex Values (£m)	NGET TO	SPT TO	SHETL TO	Elect. Total	NGG TO
Controllable Costs	215.6	20.4	5.4	241.4	64.3
Non Controllable Costs	106.4	13.6	3.7	123.7	78.9
Total 2006/7 Actual Opex	322.0	34.0	9.1	365.1	143.2
Controllable Costs	184.9	16.8	6.1	207.8	56.3
Non Controllable Costs	109.2	14.6	3.8	127.6	69.7
Total 2006/7 Final Proposals	294.1	31.4	9.9	335.4	126.0
Controllable Cost Over/(Under) spend	30.7	3.6	(0.7)	33.6	8.0
As a percentage	+17%	21%	-11%	+16%	+14%
Licensee 2006/7 Forecast in TPCR4	333.6	32.0	10.9	376.5	176.8
Final Proposals for 2007/08	317.7	33.5	11.3	362.5	158.2

2.6. Table 2.1 above also shows that overall for the Electricity TO's the actual operating costs £365.1m out-turned slightly lower by £10.4mm (3%) than their forecast for TPCR4 of £376.5m and virtually identical to the allowance of £362.5m (in 2006/07 prices) determined in TPCR4 for next year.

## Capital Costs for 2006/07

2.7. Table 2.2 below shows total outturn capital expenditure on new and replacement assets for 2006/07 compared to allowances.

2.8. The total actual capital expenditure by Electricity TO's of £612.3m was just 4% below the equivalent value in the 2006/7 Final Proposals of £652.9m. In contrast in Gas (excluding Milford Haven of £351.8m) the capex of £151.5m exceeded the allowance of £63.1m. However all this extra cost, which was largely load related expenditure, was incorporated into our TPCR4 Final Proposals and consequently the RAV used to determine the price control revenue.

Table 2.2 Capex Values (£m)	NGET TO	SPT TO	SHETL TO	Elec. Total	NGG TO
Non Load	282.9	54.4	16.2		41.8
Load excluding Milford Haven	224.5	25.8	8.5		109.7
Milford Haven (Note 1)	n/a	n/a	n/a		351.8
Subtotal for Provisional RAV	507.4	80.2	24.7	612.3	503.3
Logged up capex	4.0	1.0	0		0.1
Incremental capex	N/a	n/a	n/a		59.8
TIRG	1.2	9.5	0.2		n/a
Total Actual Expenditure	512.5	90.7	24.9		563.3
Non Load	268.1	62.4	12.3		48.5
Load	228.8	13.5	4.7		14.6
Total 2006/7 Final Proposals	496.9	75.9	17.0	652.9	63.1
Licensee 2006/7 F'cast for TPCR4	611.3	119.3	29.8	760.4	481.5
Final Proposals for 2007/8	512.8	116.0	30.0	658.8	511.1

Note 1 At the last gas price control Milford Haven was separately classified and no specific allowance was set.

2.9. The actual capex by the Electricity TO's of £612.3m was some £148.1m (19%) lower than their TPCR4 forecasts of £760.4m and much nearer the Ofgem Final Proposals forecast of £658.8m. In addition, the Scottish licensees underspent on load related items because of delays in obtaining consents by new wind generators.

2.10. If we had used licensee forecasts for 2006/7, then allowed revenue for 2007/8 and the remainder of the price control would have been higher than necessary. The licensees did not seek to reduce their 2006/7 price control forecasts in September 2006 despite having the option to do so.

2.11. We have noted for TPCR5 that the licensees did not actively seek to reduce their price control forecasts in September 2006 despite having the option to do so.

2.12. National Grids expenditure (Gas & Electricity) was not materially different from the Ofgem forecast. However the Scottish licensees underspent on load related items because of delays in obtaining consents by the wind generators, with non load expenditure somewhat higher to mitigate this. Further details on actual expenditure are provided by the licensees in their commentaries in the next chapter.

## Forecast Capex for TPCR5

2.13. We also asked the companies to provide us with updated capex forecasts for the TPCR4 price control period. Table 2.3 below compares this with TPCR4 Final Proposals and their TPCR4 forecasts in September 2006. In electricity total capex across the companies is currently forecast to outturn at £4,984.4m, some £455.9m (11%) above the Final Proposals value of £4,005.9m. In gas the forecast remains some £145m (17%) above the allowance of £877.7m.

Table 2.3 Capex 2007/12 (£m)	NGET TO	SPT TO	SHETL TO	Elec. Total	NGG TO
Sept 06 Licensee Capex Forecast	4016.3	759.5	208.6	4984.4	1432.9
2007/08	653.0	135.6	43.1		609.1
2008/09	716.9	213.8	57.1		249.3
2009/10	747.1	157.8	27.7		62.9
2010/11	721.9	143.7	13.7		57.9
2011/12	<u>701.7</u>	<u>106.9</u>	<u>21.8</u>		<u>43.5</u>
Latest Licensee Capex Forecast	3540.6	757.8	163.4	4461.8	1022.7
Change in Forecast in £m	-475.7	-1.7	-45.2	-522.6	-410.2
As a percentage (%)	-12%	0%	-22%	-11%	-29%
TPCR4 Final Proposals Forecast	3168.7	644.7	192.5	4005.9	877.7
Latest Forecast v Final Proposals	+371.9	+113.1	-29.1	+455.9	+145.0
As a percentage (%)	+12%	+18%	-15%	+11%	+17%

2.14. In summary, the companies are currently forecasting a 11% overspend on electricity and 17% on gas compared to TPCR4 Final Proposals. However, this latest forecast represents a reduction of £522.6m (11%) from the electricity TO's September 2006 forecasts for TPCR4, taking the forecast closer towards our Final Proposals value. In gas the similar reduction in forecasts of £410.2m represents a 29% fall and has occurred notwithstanding a major increase in Milford Haven costs.

2.15. This latest forecast represents a reduction of £522.6m (11%) from the electricity TO's forecasts in TPCR4 of £4984.4m taking the forecast closer towards our forecast. However NG and SP have indicated these forecasts do not yet fully reflect all the changes anticipated. Consequently in future years we will also examine the volume of asset replacement relative to the expectations for the agreed price control period when determining the overall package of allowances. In gas the reduction of £410.2m represents a 29% fall and has occurred notwithstanding a £200m+ increase in costs for Milford Haven. This is the second consecutive year in which the expected costs for this project have risen by over 30% within the space of a year.

## Provisional RAV

2.16. The Transmission Price Control – Final Proposals (Ref 206/06) published in December 2006 (TPCR4-FP) in Appendix 2 (paragraph 1.34) stated *"To provide greater confidence, we intend to publish updated RAV information on an annual basis. This will set out our provisional view of the RAV based upon the information obtained under the regulatory reporting regime. Nevertheless, we intend to continue to undertake a detailed efficiency review of expenditure at the end of the review period which may highlight the need for further adjustments."*

2.17. In 2006/07 no schemes have been considered on the aspect of efficiency, instead only the processes and methods have been examined and areas of concern identified for consideration in TPCR5. THE RAV is therefore provisional. Table 2.4 below shows the provisional RAV roll forward from final proposals.

2.18. In estimating this RAV, we have applied the approach identified in the TPCR4 Final Proposals. The provisional RAVs have been rolled forward in accordance with the license but they do not include all network investments. Certain expenditure incurred in 2006-07 will, after review, be included in RAV at a future date.

Table 2.4 Provisional RAV (£m)	NGET TO	SPT TO	SHETL TO	Elec Total	NGG TO
Final Proposals RAV b/fwd (in 2004/05 prices)	5304.6	715.3	276.2	6296.1	2590.8
RPI Inflation of 2.6%	138.0	18.8	7.1	163.9	67.4
RPI Inflation of 3.7%	<u>201.4</u>	<u>27.2</u>	<u>10.5</u>	<u>239.1</u>	<u>98.4</u>
RAV b'fwd (in 2006/07 prices)	5644.0	761.3	293.8	6699.1	2756.6
RAV provisional additions (Table 4.5)	507.4	80.2	24.7	612.3	503.3
RAV depreciation	-394.5	-64.5	-17.0	-476.0	-94.8
RAV c'fwd (average RPI)	5756.9	777.0	301.5	6835.4	3165.1
RAV c'fwd (end year RPI )	5874.3	792.8	307.6	6974.7	3229.6

2.19. In practice it proved necessary to make specific adjustments to the licensee's initial estimate and further details on these are provided in table 2.5 below.

Table 2.5 Capital Expenditure (£m)	NGET TO	SPT TO	SHETL TO	Elec Total	NGG TO
Regulatory Accounts Capex	594.0	105.4	24.7	724.1	600.0
Deduct IFRS requirement for IDC	32.0	n/a	n/a	32.0	23.4
Deduct Non Operational Capex	14.8	2.0	0	16.8	2.9
Deduct Capitalised Depreciation of Non Operational Assets		3.1		3.1	
Deduct TIRG	1.2	9.5		10.7	
Deduct Incremental Capex					59.8
Deduct other logging up items	4.0	1.0		5.0	0.1
Deduct other					2.3
Deduct Income Contributions	21.1	2.3		23.4	8.2
Deduct Sales as scrap	4.9			4.9	
Deduct Alliance set up costs	9.4			9.4	
Deduct Excess overheads		1.0		1.0	
Deduct Related party margins		6.3		6.3	
Add Rounding	0.8				
RAV after provisional review	507.4	80.2	24.7	612.3	503.3

2.20. Table 2.5 above summarises the capex adjustments to submissions from the supplied regulatory accounts and segmental analysis. These arise from items excluded from RAV such as interest during construction, related party margins, general overheads and non operational capex each of which are discussed further in the section below. It also became evident that there are issues relating to the allocation of overheads to capital expenditure that required further adjustment.

### **Capitalisation Items**

2.21. There are a number of differences between the expenditure which companies treat as capital for the purposes of their published accounts and the expenditure which is viewed as appropriate for inclusion in the Regulatory Asset Value. To aid transparency we have specifically identified such items in table 2.5 and are described below.

2.22. National Grid statutory accounts capitalise interest incurred during construction whereas the Scottish licensees have not. Because a return is provided on capital expenditure as part of the price control it is not appropriate for the RAV to include these costs and consequently they are removed.

2.23. Non operational capex is expenditure, usually capitalised in statutory accounts, which has not been incurred on the operational system of the licensees. This is usually on items such as personal computers and vehicles which can also be supplied as services and consequently is provided for when setting the allowance for controllable costs. Such expenditure is therefore removed from the RAV.

2.24. In some group structures it is possible for charges to the licensee regulated business to include items which would not be treated as part of the RAV if they had been directly incurred by that business. Examples of this are depreciation on non operational expenditure and related party margins.

2.25. There can be capital expenditure on items which are being remunerated via a different form to the baseline revenue allowance. This type of expenditure is therefore also removed from the RAV although it may become part of the RAV at a later date dependent on the form of revenue adjustment. Examples of this include TIRG, Incremental Capex and logged up expenditure.

2.26. The treatment of customer contributions may be in the form of an advance to mitigate against future charges. These advances will not form part of the baseline revenue allowance and consequently such receipts are deducted from the overall expenditure on the RAV.

2.27. Where a customer receives monies from the disposal of operational assets or assets that become surplus to operational requirements or from assets as scrap these receipts are deducted from the RAV to reflect its reduced value.

2.28. In NGET the "Alliance" is an initiative which ensures suppliers are committing dedicated resources to their capex programme. The initial set up costs for the Alliance £9.4m have been capitalised by NGET. We have not included this in the provisional RAV because restructuring costs are disallowed by Ofgem when determining allowances. It should be noted that during TPCR5 the licensee may, or may not, be able to justify its inclusion in the final RAV determined at that time.

In the Transmission Price Control : Final Proposals (Ref 206/06) published 4th December 2006 in Appendix 2 on the RAV mechanism we stated (paragraph 1.30) that *"The categories of costs which will be included within the RAV are.....a consistent proportion of capitalised operating costs to those reflected in setting the price controls"*. Thus a larger level of overheads would not be included in RAV. Table 2.6 below indicates that percentage of indirect costs capitalised by SPT is at a higher percentage in 2006/07 and needs reducing by a further £1m to be equivalent to the

Table 2.6 SPT Indirect Cost Capitalisation (£m)	2004/05 £m	2006/07 £m
Total Indirect Costs	18.2	27.0
deduct Indirect Costs in Opex	-9.5	-10.8
equals Indirect Costs in Capex	8.7	16.2
deduct Non Operational Depreciation capitalized	-1.2	-3.1
deduct Related party margins indirectly capitalised (Note 1)	0	-1.0
deduct Excess indirect capitalisation	0	-1.0
equals Indirect capitalisation for RAV	7.5	11.1
As a percentage	41.2%	41.2%

levels used for TPCR4.

Note 1: being related party margins of £6.3m minus £5.3m directly identified.

2.29. In the Transmission Price Control: Final Proposals (Ref 206/06) published 4th December 2006 in Appendix 2 on the RAV mechanism we stated (paragraph 1.29) that *"Related party profit margins will be excluded from the definitions above (ie. of direct or indirect costs capitalisable) unless the related party concerned earns at least 75 per cent of its turnover from sources other than related parties and charges to the licenses entity are consistent with charges to external customers"*. SP Power Systems only have 11% of their turnover from external businesses they have not been able to demonstrate that either condition is met. We have therefore reduced the provisional RAVs by £6.3m to reflect these margins.

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### 3. Data on individual transmission licensees

3.1. This chapter provides the comparison between allowances and actual expenditure for each licensee in nominal terms. This is based upon our conversion of the allowances set in real terms during their respective price controls and the submissions by the licensees in their Regulatory Reporting Packs. After each table there is a statement by the licensee on their expenditure to provide greater clarity on this.

3.2. It may be helpful to note the following definitions in respect of data in the tables:

- "Cash Controllable Costs" excludes irregular provisions (eg. restructuring costs), and the net movement in provisions but includes the "non operational" capital expenditure which has been excluded from the assessment of RAV.
- "Non operational capex" is capital expenditure on items other than the operational system (eg. personal computers, vehicles) only capital expenditure on the operational system that is included as additions to the provisional RAV. Final RAV is determined at TPCR5.

#### Observations

3.3. The gas price control in 2001 did not identify a split of the opex allowance between elements (ie. Controllable Costs and Non Controllable Costs). Consequently a ratio using actual values has been used to split this element for the comparison.

3.4. Net debt can include financing for significant network assets that are not as yet included the provisional RAV (eg. logged up costs and revenue driven expenditure). This expenditure may be capital in nature and has been funded by the licensee (potentially with debt) and will, if efficient, attract relevant income allowances in the future and may thus be viewed as "shadow RAV". Consequently the gearing indicated will overstate to that extent the percentage relative eventual final RAV.

3.5. SPTL: The licensee has not provided a comment on the controllable opex variance because it is their hope that Ofgem will reconsider its view of the disallowances on overheads as part of TPCR5 and if so the variance would then be less than £1m and would not require comment.

## National Grid Gas (NGG)

Table 3.1 NGG TO

<b>NGG - NTS TO</b>		
<b>Controllable Opex</b>	<b>Actual</b>	
	<b>£m</b>	
Accounting Controllable Opex	58.7	
Pensions	5.0	
Non operational capex	2.9	
Total	66.6	
Net movement in provisions	-2.3	
	<b>Allowance</b>	<b>Actual</b>
	<b>£m</b>	<b>£m</b>
<b>Cash Controllable Costs</b>	<b>56.3</b>	<b>64.3</b>
		<b>8.0</b>
<b>Non Controllable Costs</b>	<b>Allowance</b>	<b>Actual</b>
	<b>£m</b>	<b>£m</b>
Transmission Licence Fees		9.7
Network Rates		69.1
Agency Costs (Xoserve)		
<b>Total</b>	<b>69.7</b>	<b>78.9</b>
		<b>9.2</b>
<b>Capex</b>	<b>Allowance</b>	<b>Actual</b>
	<b>£m</b>	<b>£m</b>
Load Related	14.6	109.7
Milford Haven	n/a	351.8
Non Load Related	48.5	41.8
<b>Subtotal</b>	<b>63.1</b>	<b>503.3</b>
Incremental Capex		59.8
Logged Up Costs		0.1
Total		563.3
Additions		503.3
Ofgem Adjustments		0
<b>RAV additions (provisional)</b>		<b>503.3</b>
<b>Gearing / Interest (From Debt table)</b>	<b>Actual</b>	
Interest Costs	57.5	
Net Debt	1783.8	
Provisional RAV	3165.1	
Gearing as % of provisional RAV	56.4%	
<b>System Activities and Performances</b>	<b>Actual</b>	
NTS Length Km	6,962	
Installed Compressor Power (MW)	1,214	

**LICENSEE'S COMMENTS**

3.6. Whilst controllable costs appear to be higher than allowances, certain costs were allowed and recovered the following year. The remaining costs increases comprise of a development claim under a pipeline easement and unremunerated 'spend to save' efficiency initiatives that have to be self-funding out of future cost savings.

3.7. Capital expenditure included three major customer-driven entry (South Wales and Trans-Pennine load related pipeline) and exit (South West reinforcement) capacity schemes.

3.8. Non-load related expenditure primarily relates to Emissions reduction and replacement due to asset health.

3.9. Care needs to be taken when comparing actual Capex costs with allowances due to timing differences and treatment of future revenues between licenses.

## National Grid Electricity Transmission (NGET)

Table 3.2 NGET TO

### NGET Transmission - TO

#### Controllable Opex

Accounting Controllable Opex
Pensions
Non operational capex
Total
Net Movement in Provisions

Actual
£m
183.9
12.4
14.8
211.1
4.5

#### Cash Controllable Costs

Allowance	Actual	Variance
£m	£m	£m
184.9	215.6	30.7

#### Non Controllable Costs

Transmission Licence Fees
Network Rates
<b>Total</b>

Allowance	Actual	Variance
£m	£m	£m
	12.6	
	93.8	
109.2	106.4	-2.8

#### Capex

Load Related
Non Load Related
<b>Subtotal</b>
Logged up capex
Security Costs
TIRG
Total

Allowance	Actual	Variance
£m	£m	£m
228.8	224.5	-4.3
268.1	297.2	29.1
496.9	521.7	24.8
	0.0	
	4.0	
	1.2	
	526.9	

Additions
Ofgem Adjustments
<b>RAV Additions (provisional)</b>

521.7
-14.3
<b>507.4</b>

#### Gearing / Interest (From Debt table)

Interest Costs
Net Debt
Provisional RAV
Gearing as a % of provisional RAV

Actual
242.0
2873.0
5757.3
49.9%

#### System Activities and Performance

Overhead Circuit km
Underground Circuit km
Measured system maximum demand (GW)
ACS system demand (GW)
Total directly connected generation (GW)
Total directly connected wind generation (GW)
Total embedded generation (GW)

Actual
13,998
666
53
56
59
-
5
313
95%

Incentivised loss of supply volume - NGET only (MWh)
System availability

**LICENSEE'S COMMENTS**

3.10. Controllable costs were higher than allowances which had been set by rolling forward extending the 2001-02 to 2005-06 price control. As such, these 'transitional' allowances took little account of known upward volume and cost pressures. Similar to gas transmission, a number of unremunerated 'spend to save' efficiency initiatives were undertaken that have to be self-funding out of future cost savings.

3.11. Capital expenditure was higher than allowances due to increases in both load and non-load related investments.

3.12. Load related expenditure largely increased due to infrastructure reinforcement projects, triggered by new customer-driven entry and exit requirements. On the generation side National Grid carried out significant reinforcement works for the Marchwood and Langage CCGT developments including new substations and overhead line works. On the demand side, major reinforcements between Elstree and Hendon, a new sub station in Lincolnshire and the provision of new capacity in Central London substations. Work was also carried out under-grounding overhead lines in East London as part of the infrastructure works required for the 2012 London Olympics.

3.13. Non-Load related expenditure also increased due to additional asset replacement reflecting the increasing need to replace ageing assets across all asset categories, to maintain reliability for customers. The level of overhead line refurbishment and fittings replacement was higher than anticipated; cable and switchgear replacement also increased versus prior year, including replacement of an ageing 275kV substation with a new gas insulated substation.

## Scottish Power Transmission (SPT)

Table 3.3 SPT from December 2004 Appendices 5 and 8

<b>SPTL</b>		
<b>Controllable Opex</b>	<b>Actual</b>	
	<b>£m</b>	
Accounting Controllable Opex	14.0	
Pension Costs	0.3	
Non operational capex	2.0	
Total	16.3	
Adjustment to capitalisation	4.1	
	<b>Allowance</b>	<b>Actual</b>
	<b>£m</b>	<b>£m</b>
	<b>16.8</b>	<b>20.4</b>
		<b>3.6</b>
<b>Cash Controllable Opex</b>		
<b>Non Controllable Costs</b>	<b>Allowance</b>	<b>Actual</b>
	<b>£m</b>	<b>£m</b>
Transmission Licence Fees	0	0.0
Network Rates	14.6	13.6
<b>Total</b>	<b>14.6</b>	<b>13.6</b>
		<b>-1.0</b>
<b>Capex</b>	<b>Allowance</b>	<b>Actual</b>
	<b>£m</b>	<b>£m</b>
Load Related	13.5	25.8
Non Load Related	62.4	64.8
<b>Subtotal</b>	<b>75.9</b>	<b>90.6</b>
		<b>14.7</b>
Logged up capex		1.0
TIRG		9.5
Total		101.1
Additions		90.6
Ofgem Adjustments		-10.4
<b>RAV Additions (provisional)</b>		<b>80.2</b>
<b>Gearing / Interest (From Debt table)</b>	<b>Actual</b>	
Interest Costs (£m)	20.9	
Net Debt	433.9	
Provisional RAV	777.0	
Gearing as % of provisional RAV	55.8%	
<b>System Activities and Performances</b>	<b>Actual</b>	
Overhead Circuit km	3,773	
Underground Circuit km	271	
Measured system maximum demand (GW)	4	
ACS system demand (GW)	4	
Total directly connected generation (GW)	7	
Total directly connected wind generation (GW)	0	
Total embedded generation (GW)	1	
Number of incentivised loss of supply events - SPT/SHETL only (#)	1	
System availability	96%	

**LICENSEE'S COMMENTS**Load Related Capital Expenditure:

3.14. The overspend against allowances was due to a number of factors; Additional actual entry expenditure, primarily for Whitelee windfarm, actual capital contributions being well below the allowance assumption, additional actual infrastructure/system service expenditure for network reconfiguration and reinforcement at Coatbridge, offset by no actual exit expenditure against an allowance.

Non-Load Related Capital Expenditure:

3.15. Non Load related expenditure was broadly in line with allowances but with some underlying variances; the replacement of cables and certain civil works only being undertaken on one major project at Dewar Place project where a greater allowance was available in 06/07. In the event, the main substation project was deferred until increased project funding was provided through the transmission price control review (TPCR4). Conversely, expenditure on the remaining non-load projects was above allowance. This increase in activity in other projects reflected our requirement to invest more in asset replacement and refurbishment as a greater proportion of our network reaches end of life.

## Scottish Hydro Electricity Transmission (SHETL)

Table 3.4 SHETL TO

		<b>SHETL</b>		
<b>Controllable Opex</b>		<b>Actual</b>		
		<b>£m</b>		
Accounting Controllable Opex			5.0	
Pensions			0.4	
Non operational capex			0.0	
<b>Total</b>			<b>5.4</b>	
<b>Cash Controllable Opex</b>		<b>Allowance</b>	<b>Actual</b>	<b>Variance</b>
		<b>£m</b>	<b>£m</b>	<b>£m</b>
		<b>6.1</b>	<b>5.4</b>	<b>-0.7</b>
<b>Non Controllable Costs</b>		<b>Allowance</b>	<b>Actual</b>	<b>Variance</b>
		<b>£m</b>	<b>£m</b>	<b>£m</b>
Transmission Licence Fees			0.0	0.0
Network Rates		3.8	3.7	-0.1
<b>Total</b>		<b>3.8</b>	<b>3.7</b>	<b>-0.1</b>
<b>Capex</b>		<b>Allowance</b>	<b>Actual</b>	<b>Variance</b>
		<b>£m</b>	<b>£m</b>	<b>£m</b>
Load Related		4.7	7.1	2.4
Non Load Related		12.3	17.6	5.3
<b>Subtotal</b>		<b>17.0</b>	<b>24.7</b>	<b>7.7</b>
Logged up capex			0.0	
TIRG			0.2	
<b>Total</b>			<b>24.9</b>	
Additions			24.7	
Ofgem Adjustments			0.0	
<b>RAV Additions (provisional)</b>			<b>24.7</b>	
<b>Gearing / Interest (From Debt table)</b>		<b>Actual</b>		
Interest Costs (£m)			6.4	
Net Debt			158.1	
Provisional RAV			307.6	
Gearing as % of provisional RAV			51.4%	
<b>System Activities and Performances</b>		<b>Actual</b>		
Overhead Circuit km			5,195	
Underground Circuit km			62	
Measured system maximum demand (GW)			2	
ACS system demand (GW)			-	
Total directly connected generation (GW)			3	
Total directly connected wind generation (GW)			0	
Total embedded generation (GW)			1	
Number of incentivised loss of supply events - SPT/SHETL only (#)			8	
System availability			96%	

## LICENSEES COMMENTS

### Operating Costs

3.16. SHETL has had another stable year as far as Operating Costs are concerned. There was an underspend of £0.7M in cash controllable Opex costs. This reflects the continuing tight control of operating costs that exists within SHETL and a number of ongoing efficiency initiatives.

### Capital Expenditure

3.17. Capital Expenditure (Capex) allowances were agreed by OFGEM in December 2004 and revised in 2006 during the 2007-2012 Price Control Review. Thus 2006/2007 represents an important transition year for SHETL as it moved to a higher level of Capex spend in line with the 2007-2012 agreed OFGEM allowances. The Table below represents SHETL's understanding of this later (and higher) OFGEM assessment and actual expenditure.

Table 3.5- Capex	Allowance (£m)	Actual (£m)	Variance (£m)
Load Related	15.7	7.1	- 8.6
Non Load Related	14.4	17.6	+ 3.2
Subtotal	30.1	24.7	- 5.4
Logged up capex		0.0	0.0
TIRG		0.2	+ 0.2
Total	30.1	24.9	- 5.2

#### a) Load Related Expenditure

3.18. As noted above SHETL Load Related Expenditure was less than anticipated in 2006/2007 due to difficulties with windfarm planning and consents. A number of developer schemes have been delayed and as a result our Capex projections have proved incorrect. Notable schemes during the year included:-

- Sloy-Inverary 3rd 132kV Circuit – We completed this Portal Construction wood pole line during the year. Construction works have been difficult as the route has very rocky terrain and required careful design. This line will benefit the transmission of DG power from the Cowal Peninsula.
- Tealing Substation 132kV Circuit Breaker (CB) replacement - An ongoing job at Tealing was the replacement of Small Oil Volume (SOV) CBs. These are now in poor condition and have reached the end of their useful lives. They are being replaced by SF6 CBs.
- Port Ann Transformer changes – Both Grid Transformers at Port Ann have been replaced with refurbished units from Taynuilt. This reduces costs overall and is our preferred solution if we have units available. The units at Taynuilt were replaced by bigger new units to address load growth issues.

**b) Non Load Related Expenditure**

3.19. SHETL Non Load Related Expenditure was slightly above allowance for the year as we moved resource from the Load Related Programme in anticipation of higher expenditure in future years. Notable schemes during the year included:-

- Charleston & Fraserburgh Grid Transformer replacement – We had two major jobs to replace grid transformers at Charleston and Fraserburgh. These units were very old and in poor condition and were replaced under a new framework contract we have with several suppliers. We also replaced the last few of the Bulk Oil Circuit Breakers on the SHETL system during the work at Charleston.
- GA10 275kV CB Replacement – Replacement of all SHETL 275kV Air Blast CBs is a key part of our ongoing Capex programme. These units suffer from ingress of moisture and subsequent cracking of insulators and have been subject to a number of Operational Restrictions over the years. We are replacing our whole population and have chosen to use two different suppliers whose units we use for adjacent bays to manage our future risks. Upon completion SHETL will have considerably improved operational flexibility.
- Sloy/Killin 132kV overhead line reconductoring – This high altitude line required a full refurbishment as both ACSR conductor and its insulators were in a poor state of repair. We also fitted fall arrest measures as required by legislation.

## 4. Amendments to Regulatory Reporting Pack (RRP) Tables

### Chapter Summary

This was the first and trial year of the Regulatory Reporting process introduced as part of the last transmission price control settlement. Consequently the need for a few amendments has been identified by the licensees and ourselves for 2007/08.

### → Questions

→ **Question 1: Do you agree with the proposed amendments?**

→ **Question 2: Are there any other additions or amendments you consider would be helpful?**

4.1. Ofgem propose making the following amendments the RRP tables in 2007/08. These are a mixture of minor amendments to address points that have arisen with the licensees during the course of this trial year and the extra tables to aid reconciliation. (NB the references are to the NG tables and similar changes will occur for the Scottish licensees).

### New Tables

- 1.8 Abbreviated Cash Flow
- 2.15 Staff and FTE Numbers – NGET and NGG only
- 3.3.10 Analysis of Tax Paid
- 4.26 Capex Forecast - Year on Year Movement
- 4.27 Capex Forecast for the price control period - Price / Volume Variance

### Amendments to Existing tables

- Index – Identification of people completing and reviewing each table and signing off overall RRP
- Universal Data - Update for 2007/08 inflation indices and price control allowances
- 1.1 Published Data – Insert Allowances
- 1.4.2 Provisions - Revised Table detailing provisions with reconciliation to balance sheet
- 2.12 SO Capex (NGET and NGG only) – Identify forecasts for future 5 years to allow comparison with TPCR4 proposals.

- 2.14 Year on Year movement in controllable costs – Identify inflation impact on previous years numbers to current price basis before seeking differences, and add a column to allow irregular items to be identified (ie provisions and reversals)
- 3.1 Pensions – New layout (Horizontal v Vertical) and reconciliation to own accounts and pension scheme accounts
- 3.2 Financial Assets & Liabilities (NGET an NGG only) – new columns to allow identification of debt instruments by form of control (where relevant) and any associated derivatives against all or part of each financial instrument and the impact on the effective interest rate.
- 4.12 Asset Age – changed to allow the information to be automatically populated from data in other tables.

4.2. The actual RRP tables can be found on the Ofgem website:

<http://www.ofgem.gov.uk/Networks/Trans/RegReporting/Pages/RegulatoryReporting.aspx>

4.3. This constitutes formal notice, in accordance with the provisions of the relevant transmission licence. We would welcome comments on the draft version of the revised rules on or before 28 May 2008. Responses must be in writing, addressed to:

Duncan Innes, Head of Transmission Regulatory Reporting.

Email address: [Duncan.innes@ofgem.gov.uk](mailto:Duncan.innes@ofgem.gov.uk)

Any questions should, in the first instance, be directed to Duncan Innes (telephone 0207 901 7108).

## Appendices

### Index

<b>Appendix</b>	<b>Name of Appendix</b>	<b>Page Number</b>
1	Responses and Questions	22
2	The Authority's Powers and Duties	23
3	Glossary	25
4	Feedback Questionnaire	26

## Appendix 1 - Responses and Questions

4.4. We welcome views on the type and format of information that users of this report would find useful.

4.5. Please send your comments to:

**Duncan Innes**

Head of Regulatory Reporting

Ofgem

9 Millbank

London

SW1P 3GE

Email: [duncan.innes@ofgem.gov.uk](mailto:duncan.innes@ofgem.gov.uk)

## Appendix 2 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.<sup>1</sup>

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly<sup>2</sup>.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- The need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- The need to secure that all reasonable demands for electricity are met;
- The need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>3</sup>; and
- The interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.<sup>4</sup>

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

<sup>1</sup> entitled “Gas Supply” and “Electricity Supply” respectively.

<sup>2</sup> However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

<sup>3</sup> under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

<sup>4</sup> The Authority may have regard to other descriptions of consumers.

- Promote efficiency and economy on the part of those licensed<sup>5</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- Protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity;
- Contribute to the achievement of sustainable development; and
- Secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- The effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- The principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- Certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>6</sup> and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

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<sup>5</sup> or persons authorised by exemptions to carry on any activity.

<sup>6</sup> Council Regulation (EC) 1/2003

## Appendix 3 - Glossary

We have produced a glossary of terms relating to Transmission Cost Review. These can be found in Appendix 1 and 2 to the following documents:

Electricity Transmission Price Control Review Cost Reporting Rules; Instructions and Guidance (version 1.0) March 2007

<http://www.ofgem.gov.uk/Networks/Trans/RegReporting/Documents1/17033-3107b.pdf>

Gas Transmission Price Control Review Cost Reporting Rules; Instructions and Guidance (version 1.0) March 2007

<http://www.ofgem.gov.uk/Networks/Trans/RegReporting/Documents1/17032-3107a.pdf>

## Appendix 4 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

- Does the report adequately reflect your views? If not, why not?
- Does the report offer a clear explanation as to why not all the views offered had been taken forward?
- Did the report offer a clear explanation and justification for the decision? If not, how could this information have been better presented?
- Do you have any comments about the overall tone and content of the report?
- Was the report easy to read and understand, could it have been better written?
- Please add any further comments?

1.2. Please send your comments to:

**Andrew MacFaul**  
Consultation Co-ordinator  
Ofgem  
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London  
SW1P 3GE  
andrew.macfaul@ofgem.gov.uk