



*Promoting choice and
value for all customers*

Our Ref: Networks/Electricity Distribution

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Dear Colleague

Assessing applications to re-open the current price control to accommodate additional costs related to the changes to the Electricity Safety, Quality and Continuity Regulations (ESQCR), Section 74A New Roads and Street Works Act 1991 (NRSWA) and the Traffic Management Act 2004 (TMA).

1. Introduction

- 1.1. The purpose of this letter is to provide an update following our letter of the 1 July 2008 which set out our "minded to" position regarding our approach to re-opener applications associated with ESQCR, NRSWA and TMA.
- 1.2. The following approach was agreed by the Authority on 17 July 2008

2. ESQCR

2.1. Allow DNOs to recover efficient costs incurred over and above DPCR4 allowances.

- 2.1.1. We consider that both direct costs and indirect costs are within scope of the reopener provided that they are fully attributable to this work. Pensions, non operational capital expenditure and indirect costs for each of the areas of the re-opener should be separately identified so we can carry out full cost comparisons both including and excluding these costs.
- 2.1.2. We have attached updated data templates to this letter to capture pension costs, non operational capital expenditure and indirect costs fully attributable to this work.

2.2. Use benchmarking to establish the efficient level of expenditure.

- 2.2.1. We will use a two stage assessment involving quantitative benchmarking and a qualitative assessment of management and contract processes to seek evidence of value for money.

2.3. Only consider costs incurred in the current price control period.

2.4. Provide some protection for DNOs that could be adversely affected by an increase in pre-arranged customer interruptions.

- 2.4.1. Where a DNO has failed to meet the planned interruption element of their interruption targets directly as a result of this work we will make an appropriate adjustment to revenue to take into account underperformance as result of the work. We consider that the overall intention of the reopener was to address uncertainty regarding the impact of additional areas on work on the DNOs' performance. As we did not factor this work into account in setting the quality of service targets for DPCR4, we

consider that such an adjustment is appropriate in this area. We will not make adjustment to the targets of DNOs that are already outperforming the planned element of their targets.

2.5. Approach to taxation and calculation of relevant adjustments as set out in our letter of the 1 July 2008

2.5.1. Direct, indirect and pension costs will be treated in accordance with the capitalisation rules set out in DPCR4 final proposals.

3. NRSWA and TMA

3.1. The uncertain costs in these areas relate to new regulations made under section 74A of NRSWA or new orders or regulations under part 3 of the TMA. We consider that efficient set up costs to enable the administration of these categories of cost are within scope of the reopener as are permit costs when these become quantifiable.

3.2. Increased contractor costs arising from "directions relating to timing of street works" are not within scope for this reopener as they fall under Part 4 of the TMA.

3.3. During our consultation the majority of companies confirmed that due to continuing uncertainty they were not intending to make an application at this stage in regard to costs associated with NRSWA or TMA; nonetheless should any company have identified initial set up costs, these can be included in their application.

3.4. Should a company make such an application for initial set up costs we interpret that paragraph 13(c) of Special Condition A3 which states "the licensee may not propose any additional relevant adjustment in the same category of costs in that year" does not prohibit them from making a further application in that year in relation to other costs associated with section 74A of NRSWA or part 3 of the TMA.

4. Next Steps

4.1. In our letter of 1 July 2008 we asked to be notified by 7 July 2008 of any serious concerns regarding our approach. A number of companies have indicated that they would not be able to meet our request to return completed data sheets and respond to the narrative questions by 1 August.

4.2. In recognition of these concerns we now request ALL companies to submit responses to our narrative questions by **15 August 2008** to coincide with submission of FBPQ returns; whether or not they intend to make a re-opener application by that date.

4.3. We remain committed to publishing final decisions by 31 October 2008 for those companies that submit completed data templates and responses to our narrative questions during July.

4.4. Applications or responses should be sent by email to simon.polley@ofgem.gov.uk or by post to Simon Polley, The Office of Gas and Electricity Markets, 9 Millbank, London SW1P 3GE.

Yours sincerely

Chris Watts

Head of the Electricity Distribution Costs and Outputs Team

Appendix 1 – Completion of cost tables

For the avoidance of doubt the costs in Tabs 1 and 2 on safety clearances and tree cutting should only include direct costs as per the RRP definitions. Tab 4 should include any pension costs, non-operational capex or indirect costs directly attributable to this work. Any companies that have already submitted their cost information should provide an updated submission on this basis. The pension costs should be the normal ongoing pension contributions. This should exclude any deficit repairs.