

Transmission Annual Report for 2007-08

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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.

Overview:

This is the second annual report on transmission licensee's costs and forecast capital expenditure based on the regulatory reporting process introduced as part of Transmission Price Control Review for 2007-12 (TPCR4). Similar reports are published by Ofgem for the gas and electricity distribution businesses.

This report sets out revenue, operating cost, capital expenditure, and returns on regulatory equity for the four licensees in respect of their transmission owner (TO) responsibilities for the year ended 31st March 2008. It also provides information on system operator (SO) responsibilities for the year ended 31 March 2008. This is the first year of the current price control. The report also sets out Ofgem's provisional assessment of the Regulatory Asset Value (RAV) for each licensee as at 31 March 2008.

Contact name and details: Martin Rodgers, Senior Manager Cost and Outputs Reporting

Tel: 020 7901 7273

Email: martin.rodgers@ofgem.gov.uk

Team: Costs and Outputs Reporting, Transmission

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 second report and covers the first year of the 2007 - 2012 price control period.

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

Associated Documents

- TPCR 2007 - 2012 Final Proposals, December 2006 (ref 206/06)
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=191&refer=Networks/Trans/PriceControls/TPCR4/ConsultationDecisionsResponses>
- Transmission Annual Report for 2006-07 (ref 60/08)
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=9&refer=Networks/Trans/RegReporting>
- Electricity Transmission Price Control Review Cost Reporting Rules; Instructions and Guidance (version 2.0) March 2008
<http://www.ofgem.gov.uk/Networks/Trans/RegReporting/Documents1/Elecrules.pdf>
- Gas Transmission Price Control Review Cost Reporting Rules; Instructions and Guidance (version 2.0) March 2008
<http://www.ofgem.gov.uk/Networks/Trans/RegReporting/Documents1/gasrules.pdf>
- Transmission Network Output Measures - Open Letter (ref 144/08)
<http://www.ofgem.gov.uk/Networks/Trans/RegReporting/Documents1/Tx%20Network%20Output%20Measures.pdf>
- Decision under Electricity Transmission Standard Licence Condition B17 network Output Measures Part B
<http://www.ofgem.gov.uk/Networks/Trans/RegReporting/Documents1/20081218B17.pdf>
- Decision under Gas Transmission Special Licence Condition C13 Network Output Measures Part B
<http://www.ofgem.gov.uk/Networks/Trans/RegReporting/Documents1/20081218C13.PDF>

Copies of these documents can be found on our website (www.ofgem.gov.uk)

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Summary

The purpose of the review

Historical data is a critical input to our price control work. At the time of the last transmission price control review (TPCR4) we therefore made a commitment to capturing and publishing annual cost reports. This will improve the quality of our information on costs, revenues, incentives and outputs 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 (TOs). This enables comparison of actual expenditure to the price control allowances set at TPCR4 and aims to inform the next price control (TPCR5). We also report on external and internal System Operator (SO) costs.

By reviewing costs on an annual basis throughout the TPCR4 period, and by setting provisional regulatory asset values, we hope to provide a solid and consistent foundation for our work during the next transmission price control review, TPCR5.

The basis for the reporting of TO and SO costs is set out in the Transmission Price Control Review Reporting Rules; Instructions and Guidance (version 2.0) April 2008. 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. In this context it is important to take account of differences in the time at which costs and investments were incurred and when consequential adjustments are made to regulatory allowances (e.g. for logged up costs and incremental investment revenue drivers). Therefore returns and RAV are understated and debt to RAV is overstated.

Results for 2007/08

Total returns on regulatory equity for TOs as a whole were 7.1% slightly above the 7% allowed return, although there was a spread from 6.9% to 9.2%. National Grid Electricity was slightly below and the Scottish TOs significantly higher due to under-spends on capital.

Total revenues across the electricity and gas TOs were £1821.9m. Total gas and electricity SO revenues were £957.8m. These are within 1% of the expected levels. The electricity SO external costs and thus income were higher than anticipated at the time the parameters for the current incentive were set.

Total controllable operating costs across the TO licensees of £288.9m are £17m (6%) above allowances. This is primarily due to higher than anticipated National Grid Electricity Transmission (NGET) operating costs; NGET expect to be within the TPCR4

allowances by the end of the price control period. Internal electricity and gas SO operating costs were £80.1m, within £1m of the allowance.

Total electricity capital expenditure by the TOs was £767.2m against an allowance of £847.9m (before calculation of incentivised capex). The spend against the allowance differed across the licensees, with NG overspending and the Scottish TOs under spending, primarily because of delays by wind farm developers in obtaining planning consents. Gas TO capex was overspent by £15m (3%) although this includes a significant over-expenditure of £100m associated with Milford Haven. Internal electricity and gas SO capital expenditure was £19m which was lower than allowance by £8m. 2007/8 saw significant increases in the price of some capital goods; as a result forecast capital volumes are lower than anticipated. The main area of concern is the reduction in the quantity of asset replacement expenditure by NGET

All licensees experienced lower real interest costs - 2-2.5% compared to the allowance of 3.75%. This resulted in an annual saving of some £64m.

The actual outturn for tax in 2007/08 will not be known until 2010 because computations are submitted with a 12 month delay and HMRC have a further year to dispute them. We will therefore publish these in later years. However early indications are that actual tax paid will be lower than modelled because of prior year rebates relating to changes in the rates and allowances by HMRC, although this is not reflected in the return on regulatory equity calculation.

Overall TO contributions to pensions were £119m, which is £13m higher than allowance of £106m. For the purpose of this report only, deficit payments are deemed to apply according to the proportions which applied during TPCR4. Thus, for National Grid Gas (NGG) some 47% of the deficit payment is deemed to relate to Early Retirement Deficit Contributions (ERDC) and/or "Centrica" employees that are not viewed by Ofgem as a regulated activity. The actual percentage will be determined at the next actuarial valuation in 2010.

1. Background and Introduction

Chapter Summary

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

Transmission

1.1. The transmission systems in gas and electricity are the onshore networks of high voltage lines and cables and high pressure pipes that enable gas and electricity to be transported from producers to consumers. Transmission networks play a key role in facilitating the competitive electricity and gas markets in Great Britain (GB), and timely investment in the networks is essential to ensure their efficient operation.

1.2. Regulation of the Transmission system is separated into two; Transmission Owners (TOs) who own and maintain the network of transmission assets and Systems Operators (SOs) who operated the network.

1.3. There are 3 Electricity Transmission Operators covering Great Britain; National Grid Electricity Transmission plc (NGET) covering England and Wales, Scottish Power Transmission Limited (SPTL) covering south and central Scotland and Scottish Hydro-Electric Transmission Limited (SHETL) for Northern Scotland. There is just one gas transmission operator National Grid Gas plc who is responsible for the National Transmission system (NTS).

1.4. The system operators covering the whole of GB are NGET for electricity and NGG for Gas.

Regulatory Reporting

1.5. In the Transmission Price Control Review Final Proposals (Ref 206/06) published in December 2006 paragraph 12.1 we made a commitment to publish an annual regulatory reporting pack:

"In previous consultations we have indicated we intended to adopt the approach initiated in DPCR4 and introduce an annual regulatory reporting pack (RRP). The licensees and credit rating agencies have generally welcomed this approach. This will improve the quality of our information on cost, revenue, and 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."

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

1.7. This is the second RRP for the Transmission Operators (TOs). It relates to the 2007/08 financial year, the first year of the current price control period 2007 to 2012. TO costs were reported in our first report, but this is the first time we have also reported information about system operation costs (SO). The information for the following licensees is included in the report:

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

Objectives

1.8. The Transmission Price Control Review Reporting Rules: Instructions and Guidance set out the objectives of the RRP. These are:

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

1.9. Thus, the key elements of the annual reporting process are to provide an overview of:

- revenue,
- operating costs,
- capital expenditure,
- financeability, and
- a provisional regulatory asset value (RAV).

1.10. The provisional RAV is calculated in accordance with the methodology set out in the TPCR4 Final Proposals, this RAV is (as in Distribution) provisional until finalised at the next price control. In transmission, we plan to undertake an efficiency assessment of historic expenditure at the next price review.

1.11. We have also developed a measure of "return on regulatory equity" as a means of comparing the overall financial performance of businesses with the assumptions built into price control allowances. This also provides some context for the more detailed assessments of components of expenditure performance arising from the annual cost reporting process

1.12. It is proposed to make some minor changes to the reporting process for future years to address points that have arisen with the licensees during the course of RRP review.

Process for 2007/08

1.13. The regulatory reporting process for 2007/08 was similar to the one followed in the previous year. Companies submitted revenue, cost, and financial data at the end of July 2008.

1.14. We then undertook a review of the information and raised a number of supplementary questions. The review involved one visit to each licensee to review performance and clarify the data submitted. This was followed by a meeting with the Managing Director of Networks and the Director of Transmission to review key findings from the reporting process.

1.15. Overall, the response from licensees was constructive

Compliance

1.16. 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 requirement for licensees to come forward with information on any errors that have occurred in previous submissions and, where inadvertent, we have not penalised them for this.

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

2. Review of Transmission Operator (TO) Performance (in 2007/08 prices)

Chapter Summary

This chapter highlights the main financial data from the licensees as Transmission Owners. The main area of concern was the reduction in the quantity of asset replacement expenditure by NGET

Questions

- **Question 1: Do you agree with the provision of an income summary?**
- **Question 2: Do you agree with the provision of forecast capital expenditure data?**

Background

2.1. In this section we have provided an overview of the main components of TO financial performance in 2007/08 compared to the price control allowances converted to this years' price level, specifically:

- Return on Regulatory Equity
- Turnover in 2007/08
- Interest costs in 2007/08
- Pension costs in 2007/08
- Operating Costs in 2007/08,
- Capital Expenditure in 2007/08,
- Forecast Capex for 2007/12, and
- Provisional RAV for 2007/08.

2.2. In the Tables we have provided overall totals on electricity for the three licensees (NGET, SPTL, SHETL), gas has one licensee (NGG).

Returns on Regulatory Equity

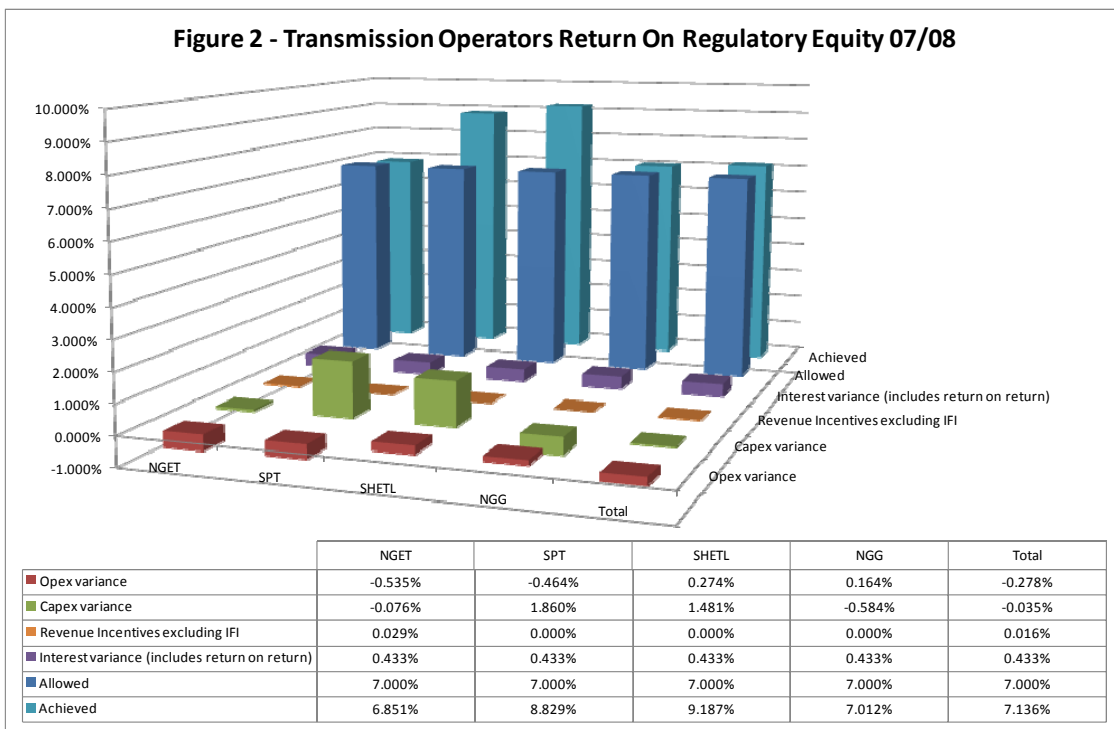
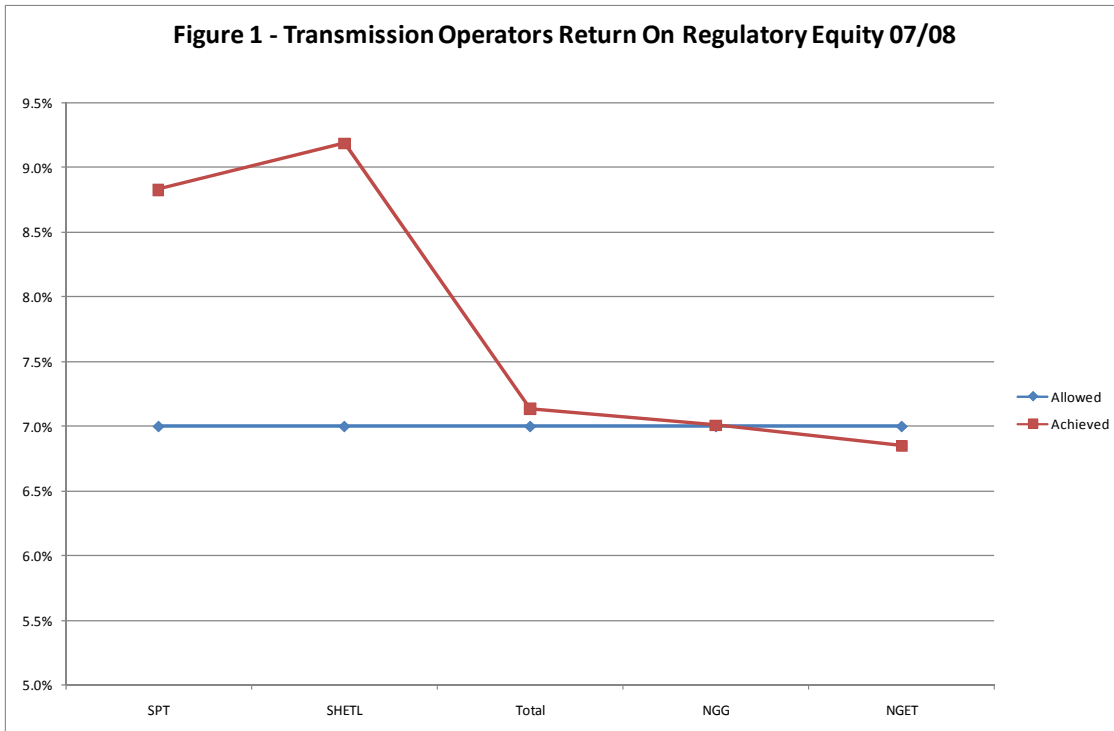
2.3. We believe it is important to understand how well our approach in Price Control Reviews encourages behaviours that we think are in customers' interests. This will help us to identify ways in which settlements and associated incentives could be improved. We think a useful way to look holistically at how companies are performing under the control is to make an assessment of each company's return on regulatory equity compared to the assumed return used in setting allowed revenues. This approach is being adopted in our current Price Control Review for electricity distribution businesses and is applied to Transmission businesses for the first time in this report.

2.4. We have developed this measure to assist us in assessing overall price control performance. It will not necessarily be consistent with standard accounting return on equity metrics. We think it will help us (and all interested parties) understand better how companies have performed. The analysis is provisional, and for future reports we may also decide to make changes to the methodology in light of responses to this report and to the ongoing consultation on the electricity distribution price control.

2.5. We think it is important that investors and company analysts understand the basis of our calculations but also why actual shareholder returns and company performance may differ from that presented in our analysis. Our analysis is based on a combination of actual data and regulatory assumptions. We do not, for example, take account of actual levels of company gearing and companies with higher (or lower) levels of gearing may earn higher (or lower) returns than if they had geared up to our notional assumption.

2.6. Further, we have only made adjustments for what we consider to be material variances from allowances, and have taken account where relevant of known ex post adjustments. We have excluded "non- controllable" costs, since any variance will be recovered ex post.

2.7. We measure return on regulatory equity by assuming the companies are geared at our notional assumption of 60.0% of RAV - not their actual level of gearing. We have reflected the difference in actual interest rates from the allowance by using a benchmark based on actual 10 year rolling average bond yields for a comfortable investment grade issuer. This allows a like for like comparison between TOs. In practice, TO actual returns will depend on their level of gearing and the extent to which their actual cost of debt has tracked market rates (this will depend on the maturity of their debt and the extent to which, for example, they have fixed or indexed linked debt). These are decisions for the companies, but in considering our approach to financial issues at price control reviews we will consider whether, in the light of actual company finance structures and market data, our assumptions about gearing when setting the cost of capital remain reasonable.



2.8. Figure 1 above shows the returns on regulatory equity allowed in the price control for each TO compared with the actual returns. Figure 2 shows the

components contributing to the overall variance. The main contributors to higher returns are lower real interest costs for all TOs and lower load related capital expenditure for the Scottish TOs. Although in future years SPTL and SHETL expect to overspend their capital allowances.

2.9. For 2007/08 we have only calculated returns on equity for TOs. For 2008/09 we intend to develop this to look at National Grid's businesses holistically and to include their SO functions in the calculation.

Price Control Revenue for 2007/08

2.10. Table 2.1 below lists the 2007/08 actual and the price control allowance. Overall, electricity and gas TO revenues are close to the allowance. All variations are accounted for by timing differences (i.e. under or over recovery arising from the use of a forecast demand that will be corrected the following year).

Table 2.1 Revenue Values (£m)	NGET TO	SPT TO	SHETL TO	Elec. Total	NGG TO
Total 2007/08 Actual Regulated Revenue	1,082.1	162.1	53.7	1,297.9	524.0
2007/08 Final Proposals	1,081.1	161.8	51.6	1,294.5	526.1
Over (Under)	1.0	0.3	2.1	3.4	(2.1)
As a % of 2007/08 Final Proposals	0.1%	0.2%	4.1%	0.3%	-0.4%

Operating Costs for 2007/08

2.11. Table 2.2 below shows total outturn operating costs (non-controllable and controllable) compared to allowances. Overall, the electricity TOs over-spent their opex allowances by 10%, but this was mainly due to over-spends by NGET and SPTL.

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

2.13. Non-operational capex expenditure (e.g. vehicles and personal computers) is included with operational expenditure in the table below because it was included within the operational cost allowance at the price control.

Table 2.2 Opex Values (£m)	NGET TO	SPT TO	SHETL TO	Elect. Total	NGG TO
Controllable Opex Costs (Note 1)	185.9	18.7	5.7	210.3	59.6
Non Operational capex	14.4	1.4	0.0	15.8	3.2
Total Controllable Costs	200.3	20.1	5.7	226.1	62.8
Non Controllable Costs	110.4	13.3	3.7	127.4	96.2
Total 2007/08 Actual Opex	310.7	33.4	9.4	353.5	159.0
Controllable Costs Allowance	182.3	17.8	6.2	206.3	66.0
Non Controllable Costs Estimate	112.6	13.9	3.9	130.4	87.5
Total 2007/08 Final Proposals	294.9	31.7	10.1	336.7	153.4
Controllable Cost Over/(Underspend)	18.0	2.3	(0.5)	19.8	(3.2)
As a percentage	9.9%	12.6%	-8.2%	9.6%	-4.8%

Note 1: These figures include various adjustments for corporate costs and excess overheads shown in the RAV calculation (Table 2.9). These adjustments are still subject to review.

Interest Cost for 2007/08

2.14. To provide a comparison for actual versus allowed financial costs, Table 2.3 below summarises the actual level of real (as opposed to nominal) interest costs from the Regulatory Accounts Profit and Loss Account, compared with the "implicit allowance" in the TPCR4 financial model for the relevant price control period. Please note that an indexation element of interest is added to the nominal debt outstanding for indexed linked debt, although this does not become a cash cost to licensees until the eventual repayment of this type of debt.

Table 2.3 Interest Costs (£m)	NGET TO	SPT TO	SHETL TO	Elect. Total	NGG TO
Price Control Real Interest Rate Assumption	3.75%	3.75%	3.75%	3.75%	3.75%
Opening Debt:					
Nominal	1,784.4	433.9	158.1		1,332.3
Indexed Linked	1,569.4	0.0	0.0		478.6
Financial Instruments	-377.0	0.0	0.0		-25.8
Closing Debt:					
Nominal	2,404.7	504.6	158.1		1,603.3
Indexed Linked	1,856.1	0.0	0.0		982.5
Financial Instruments	-916.6	0.0	0.0		-8.8
Interest:					
BS Capitalised Interest	52.1				44.5
P&L Nominal	46.0	29.6	6.1		32.3
P&L Indexed Linked Cash	45.2				15.3
P&L Indexed Linked Inflation	70.8	0.0	0.0		29.4
Interest as a %:					
Nominal	4.7%	6.3%	3.9%		5.2%
Indexed Linked (nominal)	6.8%				6.1%
Inflation	4.1%	4.1%	4.1%		4.1%
Real Interest %:					
Nominal	0.5%	2.1%	-0.3%		1.1%
Indexed Linked	2.5%				1.9%
Weighted Average Real Interest%:-					
Actual Real Interest Rate	1.4%	2.1%	-0.3%	1.5%	1.4%
Price Control Assumed Interest (Nominal £m)	198.8	31.7	12.1	242.6	95.9
Actual Interest (P&L £m)	162.0	29.6	6.1	197.7	77.0
Note: The £77.0m for NGG TO reflects the TO's 42% share of the overall Debt in NGG which in addition to SO also includes Distribution, Metering and Liquefied Natural Gas activities.					

Pension Costs for 2007/08

2.15. Table 2.4 below compares pension costs with allowed pension spend. The allowances and actual are based on the cash amount paid into the pensions scheme rather than the amount shown in the profit and loss account. For the illustration below it has been assumed that deficit payments by licensees use the TPCR4 actual valuation split pro-rata between shareholders and customers, the precise split will be determined at TPCR5.

Table 4.3 Pension Costs (£m)	NGET TO	SPT TO	SHETL TO	Elect. Total	NGG TO
Total Cash Paid to Pension Fund	39.7	2.0	1.0	42.7	72.2
Ongoing Pension Costs	15.2	1.4	1.7	18.3	16.1
Deficit Funding	41.5	0.0	0.0	41.5	29.7
Total 2007/08 Final Proposals	56.7	1.4	1.7	59.8	45.8
Pension Costs Over/(Underspend)	(17.0)	0.6	(0.7)	(17.1)	26.4
As a percentage	-29.9%	38.8%	-39.9%	-28.5%	57.7%

Capital Costs for 2007/08

2.16. Table 2.5 below shows total outturn capital expenditure on new and replacement assets for 2007/08 compared to allowances. Table 2.6 shows the calculations required to derive the incentivised capex figures. At TPCR4 an incentive was introduced to minimise the impact of over or under spend on efficiently incurred capex. Previously if a licensee overspent this would not be remunerated until the following price control, consequently a reduction in the actual return on regulated capex would occur. A capex incentivisation term was added to the license so that only 25% of the net costs / benefit from under / over spend on capex will result in a charge / gain for licensees.

2.17. Overall electricity TO capex was £767.2m, 9.5% below the TPCR4 allowances. In contrast Gas TO was over spent by 2.9%, but this was due entirely to expenditure on Milford Haven. Excluding Milford Haven other expenditure is significantly lower at £145.9m against an allowance of £231.7m.

Table 2.5 Capex Values (£m)	NGET TO	SPT TO	SHETL TO	Elec. Total	NGG TO
Non Load	329.4	53.9	13.9	397.2	37.0
Load excluding Milford Haven	314.5	26.6	28.9	370.0	139.2
Milford Haven				0.0	390.3
Pension Deficit	10.3			10.3	
Subtotal for Provisional RAV	654.2	80.5	42.8	777.5	566.5
Logged up capex	4.2	3.9		8.1	83.9
Incremental capex				0.0	102.2
TIRG	14.5	31.6	0.6	46.7	
Revenue Driver WIP	38.0				
Total Actual Expenditure	710.9	116.0	43.4	832.3	752.6
Non Load Allowance	369.3	58.2	12.7	440.2	116.9
Load Allowance (before revenue driver adjustmnt)	287.0	79.6	41.0	407.6	404.4
Pension Deficit	10.3			10.3	
Total 2007/08 Final Proposals	666.6	137.8	53.8	858.2	521.3

Table 2.6 Incentivised Capex Values (£m)	NGET TO	SPT TO	SHETL TO	Elec. Total	NGG TO
Total Capex	654.8	94.5	43.6	792.9	566.5
Less revenue driver Adjustment				0.0	
Less capitalised pensions	(4.4)	(1.3)	(0.6)	(6.3)	
less net load related sole use	(81.5)	(4.5)	(9.1)	(95.1)	
Total Actual Incentivised capex	568.9	88.7	33.9	691.5	566.5
Total Capex Allowance	666.6	137.8	53.8	858.2	521.3
Less revenue driver Adjustment	(29.4)			(29.4)	
Less capitalised pensions	(3.8)	(0.9)	(0.9)	(5.6)	
less net load related sole use	(74.7)	(12.1)	(8.0)	(94.8)	
Total Final Proposals Incentivised capex	558.7	124.8	44.9	728.4	521.3
Incentivised Capex Over / (under spend)	10.2	(36.1)	(11.0)	(36.9)	45.2
As a percentage	1.8%	-28.9%	-24.4%	-5.1%	8.7%

2.18. NGET capex is slightly higher than the allowance, but SHETL and SPTL are significantly under-spent. In the case of SHETL and SPTL, the under-spend arises because load-related expenditure is lower than anticipated. This is as a result of lower than anticipated customer driven work and difficulties that customers have experienced obtaining consents for wind and other connections.

2.19. In TPCR4, we introduced a mechanism by which licensees could "log up" certain capital costs. Under this procedure the expenditure is separately recorded and at the next price control will receive income on all efficiently incurred expenditure as though that expenditure had been included at the previous price control and the impact of this is NPV neutral for the licensee. However in the intervening period the RAV is effectively understated and the ratio Debt to RAV overstated unless due allowance is made for this "capex not yet included in the RAV". Licensees have spent £92m on Logged Up costs. This includes £83m of Milford Haven costs, security, cable tunnels, expenditure on upgrading telecoms equipment due to BT21 century and wind generation connections. These costs will be added to the RAV at the start of TPCR5 after a review for efficiency. BT21st Century refers to BT's consolidation of its telecoms network sometime in the future onto one platform; this may mean that some tele-protection services used by TOs will be incompatible with the new platform. Hence TOs may be required to replace tele-protection lines.

Forecast Capex for TPCR5

2.20. We also asked the companies to provide us with updated capex forecasts for the TPCR4 price control period. Table 2.7 compares the 2007/08 forecast for the 5 years with the forecast last year and the allowance set out in the Final Proposals.

Table 2.7 Capex Values (£m) – 2007-12	NGET TO	SPT TO	SHETL TO	Elec. Total	NGG TO
Licensee previous Capex Forecast (Jul 2007) (Note 1)	3,686.9	789.1	170.1	4,646.1	1,064.9
2007/08	644.5	94.5	43.6	782.6	626.1
2008/09	649.2	174.3	52.1	875.6	234.0
2009/10	692.5	184.4	34.1	911.0	81.0
2010/11	725.8	208.1	46.5	980.4	57.3
2011/12	742.5	147.6	40.3	930.4	45.9
Latest Licensee Capex Forecast (Jul 2008) (gross)	3,454.5	808.9	216.6	4,480.0	1,044.3
Change in Forecast in £m	(232.4)	19.8	46.5	(166.1)	(20.6)
As a percentage (%)	-6.3%	2.5%	27.3%	-3.6%	-1.9%
TPCR4 Final Proposals Forecast (pre adjustment)	3,322.2	673.6	200.5	4,196.2	913.9
Latest Forecast v Final Proposals (Note 2)	132.3	135.3	16.1	283.8	130.4
As a percentage (%)	4.0%	20.1%	8.1%	6.8%	14.3%

Note 1: It is unclear whether the previous forecast included expenditure on Regulatory WIP.

Note 2: The NGET overspend is £550m after adjusting the forecast and allowance for sole use expenditure, the revenue driver adjustment and forecast cable tunnel costs in excess of £60m

2.21. The forecasts for the price control period include one year's actual expenditure and 4 years forecasts. Overall, projected capital spend is lower than the forecasts for the TPCR4 period and those provided last year. Although SHETL and SPT have increased their forecasts to take account of increases in input prices. Although NGET's capital spend is close to the TPCR4 forecasts, the volume of capital work anticipated by NGET is significantly lower, as illustrated in Figures 2.1 below. The figure compares the Forecast Business Plan Questionnaire (FBPQ) supplied for TPCR4 covering the seven years to 2011/12 with current projections supplied in their narrative this year. Regulatory Work In Progress (WIP) is expenditure on load based schemes which are recompensed by revenue drivers, but which are not completed until after 2011/12.

Figure 2.1 Asset Class	FBPQ Forecast Volume	Current Projections	Change
Transformers	86	39	-55%
Reactors	35	16	-54%
Circuit Breakers	530	160	-70%
Overhead line (full refurbishment)	1468	576	-61%
Overhead line (fittings)	1198	1003	-16%

Provisional RAV

2.22. In the Final Proposals of the last Transmission Price Control (Ref 206/06) we made a commitment to publish updated RAV information (Ref 206/06, December 2006, TPCR4-FP), Appendix 2 of the Final Proposals (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.”*

2.23. In compiling this report we have not completed a review of the efficiency of any capital expenditure schemes. Instead, only the processes and methods have been examined and areas of concern identified for consideration in TPCR5. Our assessment of RAV is therefore provisional. Table 2.8 below summarises this provisional view.

2.24. In estimating this RAV, we have applied the approach identified in the TPCR4 Final Proposals. The provisional RAV has been rolled forward in accordance with the license but this does not, as yet, include all network investment. Certain expenditure incurred in 2007/08 will, after review, be included in RAV at a future date. This is identified as "capex not yet in the RAV" in for each licensee in Table 2.9.

Table 2.8 Provisional RAV (£m)	NGET TO	SPT TO	SHETL TO	Elec Total	NGG TO
RAV b/fwd (in 2006/07 prices)	5,756.9	777.0	301.5	6,835.4	3,165.1
RPI Inflation of 4.1%	237.8	32.1	12.5	282.4	130.7
RAV b/fwd (in 2007/08 prices)	5,994.7	809.1	314.0	7,117.8	3,295.8
RAV provisional additions (Table 2.9)	654.2	80.5	42.8	777.5	566.5
RAV depreciation	(424.2)	(69.2)	(18.1)	(511.5)	(108.8)
RAV c'fwd (at average RPI in 2007/08)	6,224.7	820.4	338.7	7,383.8	3,753.6
RAV c'fwd (at end year RPI in 2007/08)	6,329.4	834.2	344.4	7,508.0	3,816.7

2.25. In practice it proved necessary to make specific adjustments to the licensee's initial estimate of RAV. Further details of these adjustments are provided in table 2.9 below. This table summarises the capex adjustment to submissions from the supplied regulatory accounts and segmental analysis. They arise from items excluded from the RAV such as interest during construction, related party margins, general overheads and non operational capex each of which are discussed further in the capitalisation section.

Table 2.9 RAV Additions Adjustment (£m)	NGET TO	SPT TO	SHETL TO	Elect. Total	NGG TO
Regulatory Accounts Capex	788.0	138.9	44.2	971.1	779.0
Capitalised Interest	(52.1)			(52.1)	(44.5)
Deduct Non Operational Capex	(14.4)	(1.4)		(15.8)	(3.2)
Deduct Capitalised Depreciation of Non Operational Assets		(1.9)		(1.9)	
Deduct Capitalisation of Corporate / Group costs		(0.6)	(0.1)	(0.7)	
Deduct Customer Contributions	(26.2)	(7.8)		(34.0)	(7.4)
Deduct Related party margins		(6.1)	(0.6)	(6.7)	
Deduct Excess overheads		(5.1)	(0.1)	(5.2)	
Add quasi capex	6.6			6.6	
Deduct scrap sales	(0.6)			(0.6)	
Pensions deficit	10.3			10.3	
Add Glenmavis Expenditure (LGN Refurbishment)				0.0	26.6
Add West Sole capex (LNG Refurbishment)				0.0	3.6
Rounding	(0.7)			(0.7)	(1.3)
Sub total	710.9	116.0	43.4	870.3	752.8
<i>"Capex Not Yet in the RAV"</i>					
Deduct TIRG	(14.5)	(31.6)	(0.6)	(46.7)	
Deduct other logging up items	(4.2)	(3.9)		(8.1)	(0.9)
Deduct incremental capex				0.0	(102.2)
Deduct Regulatory WIP	(38.0)			(38.0)	
Deduct Milford Haven costs above allowance				0.0	(83.1)
Sub Total	(56.7)	(35.5)	(0.6)	(92.8)	(186.2)
RAV additions after provisional review	654.2	80.5	42.8	777.5	566.5

Capitalisation Items

2.26. 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 identified these in table 2.9 and they are described below.

2.27. 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.

2.28. 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. The costs of such services are provided for when setting the revenue allowance for controllable costs. Such expenditure is therefore not included in the RAV.

2.29. 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.

2.30. 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.

2.31. 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.

2.32. NGG operate certain LNG facilities to provide gas for sites remote from the NTS network (e.g. in Scotland) where it would not be economic to have a pipeline. Consequently at TPCR4 it was agreed the refurbishment of these facilities would be treated as an allowed addition to the RAV.

2.33. 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 such "capex not yet included in the RAV" include TIRG, Incremental Capex, and Logged up expenditure, Regulatory Work In Progress (WIP), and overspends on Milford Haven.

Innovation Funding Initiative (IFI)

2.34. The transmission companies have spent a total of £4.9m on IFI projects in 2007/08 and 80% of such expenditure is allowed up to a cap of 0.5% of turnover or £0.5 million whichever is the higher. These are Research and Development projects paid for by the licensee and undertaken by external parties (e.g. Universities). Table 2.10 below show the expenditure by licensee.

Table 2.10 IFI Costs (£m)	NGET TO	SPT TO	SHETL TO	Elect. Total	NGG TO
IFI Expenditure	3.0	0.2	0.4	3.6	1.3
80% allowed	2.4	0.2	0.3	2.9	1.0

3. Review of System Operator (SO) Performance (in 2007/08 prices)

Chapter Summary

This chapter summarises for the first time the expenditure by National Grid under its G.B. System Operator obligations (as NGET for electricity and NGG for gas).

Question

- ➔ **Question 1: Do you agree with the publication of this information?**
- ➔ **Question 2: What other information, if any, do you consider should be published in this report?**

Background

3.1. In this section we have provided an overview of the main components of System Operators financial performance in 2007/08 compared to the price control allowances converted to this years' price level, specifically:

- Turnover 2007/08
- Pensions 2007/08
- Operating Costs in 2007/08,
- Capital Expenditure in 2007/08,
- Forecast Capex for 2007/12, and
- Provisional RAV for 2007/08

Price Control Revenue

3.2. Table 3.1 below compares the 2007/08 actual SO revenue with either the price control revenue allowance. This includes both SO "external" and SO "internal" revenue. "External" refers to costs incurred with third parties in order to maintain system balancing, in contrast "Internal" refers to the staff and other costs incurred in operating as a system operator. Both costs usually have sharing incentive mechanisms in place.

Table 3.1 Revenue Values (£m)	NGET SO	NGG SO
Total 2007/08 Actual Regulated Revenue	683.7	274.1
2007/08 Final Proposals	684.0	278.3
Over (Under)	(0.3)	(4.1)
As a % of 2007/08 Final Proposals	0.0%	-1.5%

Operating Costs

3.3. Table 3.2 below shows the total 2007/08 outturn operating costs (non-controllable and controllable) compared to the 2007/08 Final Proposals. Overall expenditure is in line with allowances, cost increases in one area were largely offset by decreases elsewhere.

Table 3.2 Opex Values (£m)	NGET SO	NGG SO
Controllable Costs	52.6	27.5
Non Controllable Costs	0.0	4.9
Total 2007/08 Actual Opex	52.6	32.4
Controllable Costs Allowance	53.1	26.9
Non Controllable Costs Estimate	1.1	7.3
Total 2007/08 Final Proposals	54.2	34.2
Controllable Cost Over/(Underspend)	(0.5)	0.7
As a percentage	-0.9%	2.5%

Pension Costs

3.4. Total expenditure is below allowances especially for NGG SO, as shown in table 3.3 below. The allowances and actual pension costs are based on the amount paid into the pension scheme rather than the amount shown in the profit and loss account. As for in the case of TO Pension Costs, our presentation assumes that deficit payments by licensees use the TPCR4 actual valuation split between shareholders and customers, the precise split will be determined at TPCR5.

Table 3.3 Pension Costs (£m)	NGET SO	NGG SO
Total Cash Paid to Pension Fund	11.8	3.4
Ongoing Pension Costs	4.7	7.2
Deficit Funding	12.6	0.2
Total 2007/08 Final Proposals	17.3	7.4
Controllable Cost Over/(Underspend)	(5.5)	(4.0)
As a percentage	-31.8%	-54.2%

Capital Expenditure

3.5. Table 3.4 shows total outturn capital expenditure on SO projects compared to Final Proposals for 2007/08. Adjustments to actual expenditure have been made to

account for expenditure relating to previous allowances and Xoserve costs as the Xoserve allowance is all in opex. Overall expenditure is below allowances by 7.3%, this is largely due to delays / deferrals and the re-phasing of projects.

Table 3.4 Capex Values (£m)	NGET SO	NGG SO
Total Actual Expenditure	12.5	10.3
Adjustments		
Expenditure relating to prior year allowances	(3.2)	
Xoserve expenditure		(0.6)
	9.3	9.7
Total 2007/08 Final Proposals	12.3	14.2

Forecast Capital Expenditure

3.6. We also asked the companies to provide us with updated capex forecasts for the TPCR4 price control period. Table 3.5 below compares this with TPCR4 Final Proposals.

Both electricity and gas SO forecast to significantly overspend the total capital allowances by 76% and 36% respectively over the whole price control period. National Grid indicated they need to invest more than previously forecast in updating and replacing critical systems such as the Balancing Mechanism system to mitigate risks.

Table 3.5 Capex Values (£m) – 2007-12	NGET SO	NGG SO
2007/08	12.5	10.3
2008/09	17.5	19.7
2009/10	32.2	26.6
2010/11	16.1	19.5
2011/12	6.0	20.2
Latest Licensee Capex Forecast (Jul 2008)	84.3	96.3
less prior year allowance expenditure	(4.4)	
less Xoserve expenditure		(22.7)
	79.9	73.6
TPCR4 Final Proposals Forecast	45.5	54.0
Latest Forecast v Final Proposals	34.4	19.6
As a percentage (%)	76%	36%

Provisional RAV

3.7. Table 3.8 shows the provisional RAV; we have applied the approach identified in the SO final proposals.

Table 3.6 Provisional RAV (£m)	NGET SO	NGG SO
RAV b/f	47.4	44.3
RAV provisional additions	9.7	10.8
RAV depreciation	(7.5)	(16.3)
RAV c'fwd	49.6	38.7

4. Data on individual transmission licensees

4.1. This chapter provides a comparison between allowance and actual expenditure for each licensee in nominal terms. After each table there is a statement by the licensee on their expenditure to provide greater clarity on this aspect.

4.2. All the data presented is derived from the information in the regulatory reporting packs. These packs are reconciled back to the audited published information contained within the Regulatory Accounts and various elements (e.g. Income) have also been subject to audit review under agreed upon procedures determined by the Authority.

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

- "Cash Controllable Costs" excludes irregular provisions (e.g. 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 (e.g. personal computers, vehicles) only capital expenditure on the operational system that is included as additions to the provisional RAV. The final RAV will be determined at TPCR5.

4.4. Net debt can include financing for significant network assets that are not as yet included the provisional RAV (e.g. logged up costs and revenue driven expenditure). This expenditure on "Capex not yet in the RAV" 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 without the adjustment shown the gearing indicated will overstate to that extent the percentage relative eventual final RAV.

4.5. With regard to tax, the actual outturn for 2007/08 will not be known until 2010 because computations are submitted with a 12 month deadline and HMRC have a further year to make enquiries. We have therefore not published any figures now, but will publish these in later years. However early indications are that because of rebates relating to 2006/07 arising from changes in the rates and allowances made by HMRC cumulative tax paid will be lower but the ongoing tax charge for future years will be higher than when setting the allowances.

National Grid Gas (NGG)

Table 4.1 NGG TO

NGG - NTS TO			
Regulated Income	Allowance	Actual	Timing Difference
	£m	£m	£m
Final Proposals	540.1		
Adjustments from final proposals to license	(9.1)		
Difference for income specific inflation	(4.9)		
Core Allowance	526.1	524.0	(2.0)
NTS Exit Charges foregone		(55.9)	
Elimination of DN Pensions Deficit & Other Adjustments		(14.2)	
Other Income		0.3	
per NGG Regulatory Accounting Statement		454.3	
Controllable Opex		Actual	
		£m	
Accounting Controllable Opex		58.2	
Non operational capex		3.2	
Total		61.4	
Net movement in provisions / Other adjustments		1.4	
	Allowance	Actual	Variance
	£m	£m	£m
Cash Controllable Costs	66.0	62.8	3.2
Non Controllable Costs		Actual	
		£m	
Transmission Licence Fees		10.0	
Network Rates		73.2	
Agency Costs (Xoserve)		0.8	
Security Costs		12.3	
Total		96.2	
Tax	Allowance		
	£m		
Current tax	43.1		
Innovation Funding Initiative (IFI)	Allowance	Actual	
	£m	£m	
Opex (Allowance = 80% of actual spend)	1.0	1.3	
Logged Up Operating Costs		Actual	
		£m	
Opex		7.3	
Pensions	Allowance	Actual	Under / (over) Recovery
	£m	£m	£m
Ongoing	16.1	16.8	0.7
Deficit	29.7	55.5	25.8
Total	45.8	72.2	26.4
Capex (including pensions)	Allowance	Actual	Pension Costs in actual
	£m	£m	£m
Load Related	404.4	529.6	1.2
Non Load Related	116.9	43.5	0.1
Subtotal	521.3	573.1	1.3
Capex Not Yet Included in RAV			
Incremental Capex		102.1	
Logged Up Costs (Includes £83m for Milford Haven)		84.0	
Total		759.3	
Incentivised Capex	Allowance	Actual	Variance
	£m	£m	£m
Total Capex	521.3	573.1	
Ofgem Adjustment		(6.6)	
Total Capex	521.3	566.5	45.2
Additions		573.1	
Ofgem Adjustments (deferred for consideration)		(6.6)	
Provisional RAV additions		566.5	
Gearing / Interest		Actual	
Interest Costs		123.1	
Net Debt		2,134.2	
Provisional RAV (at year end price level)		3,816.7	
Capex not yet in the RAV		192.8	
Gearing as % of provisional RAV and capex not yet in the RAV		53%	
System Activities and Performances		Actual	
NTS Length Km		7,383	
Installed Compressor Power (MW)		1,261	

Table 4.2 NGG SO

NGG - NTS SO

Regulated Income

Core Allowance
Balancing neutrality charges
Capacity Management costs
Other Income
per NGG Regulatory Accounting Statement

Target	Actual	Variance
£m	£m	£m
278.3	274.1	(4.1)
	(11.4)	
	(2.9)	
	0.1	
	259.9	

Controllable Opex

Accounting Controllable Opex
Net movement in provisions

Actual		
£m		
	26.8	
	0.7	
Allowance	Actual	Variance
£m	£m	£m
26.9	27.5	(0.7)

Cash Controllable Costs**Non Controllable Costs**

Agency Costs (xoserve)

Actual
£m
4.9

Tax

Current tax

Allowance
£m
3.4

Logged Up Costs

Total

Actual
£m
-

Pensions

Ongoing
Deficit

Total

Allowance	Actual	Under / (over) Recovery
£m	£m	£m
7.2	3.2	(4.0)
0.2	0.2	0.0
7.4	3.4	(4.0)

SO Capex**Total**

Allowance	Actual	Variance
14.2	9.7	4.5

Gearing / Interest

Interest Costs
Net Debt
Provisional RAV (at year end price level)
Gearing as % of provisional RAV

Actual
1.3
19.5
38.7
50%

LICENSEE'S COMMENTS**NGG Transportation Owner (TO)**

The year to March 2008 saw very significant pipeline construction activity with approximately 400km of new gas pipelines being completed. A major new pipeline from Pannal to Nether Kellett was commissioned. Together with upgrades to the Easington terminal, this will play a significant part in enabling National Grid to transport gas imported from Norway to consumers. Major construction activity was also carried out in South Wales to ensure that the pipelines from Milford Haven to Aberdulais and Tirley were operationally available in the critical winter period. During this extremely high level of construction activity, certain unforeseen events led to cost increases on projects to which National Grid had committed to deliver capacity in the timescales required by its customers. In particular, the wet weather experienced during summer 2007 – the peak construction season – was unprecedented. The resultant saturated ground and flooding resulted in a significant loss of construction days, necessitating acceleration measures to ensure projects were delivered on time.

Scaling up of design and construction capabilities has commenced to deliver the increased activity levels which will be required to maintain our ageing assets in a safe and reliable condition. Accordingly, non-load related investment will increase over the next few years.

As with all Transmission licensed revenue streams, actual TO revenues remain in line with allowed revenues. Despite changes in system usage, i.e. demand-side response to weather conditions and energy prices, and the requirement to set charges between six months and a year in advance, the resultant timing difference, less than ½% under-recovery in this case, was relatively minor.

Controllable costs were lower than allowances primarily as a result of efficiency improvements and the variance on pension costs relates to timing differences.

NGG System Operator (SO)

Actual SO revenues were in line with allowed revenues. Despite the volatility in the cost of shrinkage gas caused by fluctuations in energy prices, and the requirement to set charges between six months and a year in advance, the resultant timing difference, approximately 1½% under-recovery in this case, was relatively minor.

Controllable costs were in line with allowances and the variance on pension costs related to timing differences.

National Grid Electricity Transmission (NGET)

Table 4.3 NGET TO

NGET Transmission - TO			
Regulated Income	Allowance	Actual	Timing Difference
	£m	£m	£m
Final Proposals	1,092.6		
Adjustments from final proposals to license	1.8		
Difference for income specific inflation	(13.3)		
Core Allowance	1,081.1	1,082.1	1.0
Excluded Services		69.0	
Allowed Adjustments		(2.6)	
Timing Differences		(3.3)	
per NGET Regulatory Accounting Statement		1,145.2	
Controllable Opex		Actual	
		£m	
Accounting Controllable Opex		185.7	
Non operational capex		14.4	
Total		200.1	
Net movement in provisions / other adjustments		0.2	
	Allowance	Actual	Variance
	£m	£m	£m
	182.3	200.3	(18.0)
Cash Controllable Opex			
Non Controllable Costs		Actual	
		£m	
Transmission Licence Fees		12.9	
Network Rates		97.5	
Total		110.4	
Tax	Allowance		
	£m		
Current Tax		112.1	
Innovation Funding Incentive (IFI)	Allowance	Actual	
	£m	£m	
Opex (Allowance is 80% of actual spend)		2.4	3.0
Logged Up Operating Costs		Actual	
		£m	
Opex		0.0	
Pensions	Allowance	Actual	Under / (over) Recovery
	£m	£m	£m
Ongoing	15.2	12.9	(2.3)
Deficit	41.5	26.8	(14.7)
Total	56.7	39.7	(17.0)
Capex (including pensions)	Allowance	Actual	Pension costs in actual
	£m	£m	£m
Load Related	287.0	314.4	2.1
Non Load Related	369.3	330.1	2.2
Pension Deficit	10.3	10.3	
Subtotal	666.6	654.8	4.4
Capex not yet included in the RAV			
Logged up capex		4.3	
TIRG		14.5	
Revenue driver WIP		38.0	
Total		711.6	
Incentivised Capex	Allowance	Actual	Variance
	£m	£m	£m
Total capex	666.6	654.8	
less revenue driver adjustment	(29.4)		
less capitalised pensions	(3.8)	(4.4)	
less net Load related sole use	(74.7)	(91.5)	
Total	558.7	569.0	(10.2)
Capex Additions		654.8	
Ofgem Adjustments		(0.6)	
Provisional RAV Additions		654.2	
Gearing / Interest		Actual	
		£m	
Interest Costs (£m)		207.1	
Net Debt		3,279.7	
Provisional RAV (at year end price level)		6,329.2	
Capex not yet included in the RAV		56.8	
Gearing as % of provisional RAV and capex not yet in RAV		51.4%	
System Activities and Performances		Actual	
Overhead Circuit km		13,998	
Underground Circuit km		656	
Measured system maximum demand (GW)		54.7	
Total directly connected generation (GW)		58.9	
Total directly connected wind generation (GW)		-	
Total embedded generation (GW)		5.1	
Incentivised loss of supply volume - NGET only (MWh)		6	
System availability		95.1%	
SF6 leakage rate (tonnes)		13.2	

NGET Transmission - SO

Regulated Income

External
Internal
Balancing Services Use of System Charges
Scottish & Hydro Charges
Other Income
per NGET Regulatory Accounting Statement

Target	Actual	Variance
£m	£m	£m
570.5	570.8	0.3
113.5	112.9	(0.6)
684.0	683.7	(0.3)
	274.0	
	3.1	
	960.8	

Controllable Opex

Accounting Controllable Opex
Net movement in provisions / other adjustments

Actual	Allowance	Actual	Variance
£m	£m	£m	£m
52.6	53.1	52.6	0.5
-			

Cash Controllable Opex

Tax

Current tax

Allowance
£m
9.3

Logged Up Costs

Operating Costs
Capital Expenditure
Total

Actual
£m
0.8
-
0.8

Pensions

Ongoing
Deficit

Allowance	Actual	Under / (over) Recovery
£m	£m	£m
4.7	3.6	(1.0)
12.6	8.1	(4.5)
17.3	11.8	(5.5)

Total

SO Capex

Total

Allowance	Actual	Variance
£m	£m	£m
12.3	9.3	3.0

Gearing / Interest

Interest Costs (£m)
Net Debt
Provisional RAV (at year end price level)

Actual
1.6
26.1
49.6
52.6%

LICENSEE's COMMENTS**NGET Transmission Owner (TO)**

During 2007/08 National Grid increased investment in the electricity transmission network by 30% to over £700m. This investment provided new capacity for generation and demand and helped to maintain high levels of network reliability.

Despite exceptionally wet weather over the important summer period, delivery of the capital programme was not adversely affected. However, the capital programme was affected by commodity price rises because commodities such as copper, aluminium and oil form a large part of the equipment used by National Grid. A high level of worldwide demand for key types of equipment also tended to increase the cost of major capital projects.

In response to increases in capital costs we managed asset replacement volumes, as incentivised by the price control, to mitigate the financial impact on the company and consumers. In pursuing this volume reduction we took careful account of the potential impact on network reliability.

This was the first year of National Grid's long-term supplier alliance arrangements. Six partnerships have been established to deliver much of National Grid's overhead line and substation works for the period through to March 2012. Over 40% of the 2007/08 investment programme was delivered through these arrangements. This proportion will increase in future as many of the projects being developed with alliance partners are delivered.

Investment to provide new capacity for generation and demand increased markedly. Important projects included connection of the Marchwood Power generation development near Southampton and the Severn Power generation development at Uskmouth. Major works were also carried out in the Thames Estuary area to facilitate new generation at the Isle of Grain and wind farm connections.

Investment to replace less reliable assets increased in line with recent years and further increases are planned over the next few years. Significant investment continues to be made in overhead line routes and underground cable investment increased as older oil-filled cables were replaced.

Actual TO revenues were in line with allowed revenues. Despite changes in system usage, i.e. demand-side response to weather conditions and energy prices, and the requirement to set charges up to a year in advance, the resultant timing difference, £1m over-recovery in this case, was relatively minor.

Controllable costs were above the allowance in the first year of the new price control period. Whilst significant progress has already been made in delivering planned efficiency savings, further planned improvements are necessary to reduce costs to the level of future year TPCR4 allowances. The variance on pension costs related to timing differences.

NGET System Operator (SO)

Unlike other licensed revenue streams, SO external balancing services and internal costs are recovered via half-hourly charges. Small differences between target and actual costs arise from final and prior year reconciling items.

Controllable costs are in line with allowances, with increased levels of critical operating system resilience and support costs being offset by efficiency improvements. The variance on pension costs related to timing differences.

Scottish Power Transmission (SPT)

Table 4.5 SPT

SPTL			
Regulated Income	Allowance	Actual	Timing Difference
	£m	£m	£m
Base Price Control	163.3	161.9	
Difference for income specific inflation	(1.4)		
Under / Over Recovery (Current Year)		0.2	
	161.9	162.1	0.2
Excluded Services		1.5	
Allowed Adjustment		3.4	
Timing Differences		4.7	
Total Regulatory Turnover		171.7	
Controllable Opex		Actual	
		£m	
Accounting Controllable Opex		11.1	
Non operational capex		1.4	
Total		12.5	
Adjustment to capitalisation (to be recalculated)		7.6	
	Allowance	Actual	Variance
	£m	£m	£m
Cash Controllable Opex	17.9	20.1	(2.2)
Non Controllable Costs		Actual	
		£m	
Network Rates		13.3	
Tax	Allowance		
	£m		
Current tax	19.4		
Innovation Funding Incentive	Allowance	Actual	
	£m	£m	
Opex (Allowance =80% of actual spend)	0.2	0.2	
Logged Up Operating Costs		Actual	
		£m	
Opex		0.0	
Pensions	Allowance	Actual	Under / (Over) Recovery
	£m	£m	£m
Ongoing Costs	1.4	2.0	(0.5)
Capex (including pensions)	Allowance	Actual	Pension costs in Actual
	£m	£m	£m
Load Related	79.6	26.6	0.4
Non Load Related	58.2	67.9	1.0
Subtotal	137.8	94.5	1.3
Capex Not Yet Included in RAV			
Logged up capex		3.9	
TIRG		31.6	
Total		130.0	
Incentivised Capex	Allowance	Actual	Variance
	£m	£m	£m
Total capex	137.8	94.5	
less capitalised pensions	(0.9)	(1.3)	
Less net Load related sole use	(12.1)	(4.5)	
Total	124.8	88.7	36.1
Additions		94.5	
Ofgem Adjustments		(14.0)	
Provisional RAV Additions		80.5	
Gearing / Interest (From Debt table)		Actual	
		£m	
Interest Costs (£m)		29.6	
Net Debt		504.4	
Provisional RAV (at year end)		834.0	
Capex not Yet included in RAV		35.5	
Gearing as % of provisional RAV and Capex net yet included in RAV		58.0%	
System Activities and Performances		Actual	
Overhead Circuit km		3,753	
Underground Circuit km		288	
Measured system maximum demand (GW)		4.2	
Total directly connected generation (GW)		7.1	
Total directly connected wind generation (GW)		0.6	
Total embedded generation (GW)		0.7	
Number of incentivised loss of supply events (#)		11	
System availability		92.2%	
SF6 Leakage Mass (Kg)		930.0	

LICENSEE's COMMENTS

Revenue

Revenue received by SP Transmission Ltd in 2007/08 is in line with allowed revenue as prescribed in our Licence

Costs

Cash controllable opex costs were below allowance for 2007/08 due to reductions in Inspection and Maintenance activity and associated overheads. Expenditure in this area has been constrained by the level of construction activity undertaken and a significant cable replacement programme further contributing to a reduction in cable maintenance costs within the period.

Tax

For the year ended 31 March 2008 the corporation tax charge of £16.5m was reduced by a credit of £8.5m in relation to the adjustment of prior years. The deferred tax charge of £9.6m includes a £10.5m charge in relation to the adjustment of prior years that is offset by a £5.4m credit due to the change of rate on deferred tax.

Capex

Our lower than forecast customer load investment is due to the volatility in the timing of renewable generation projects, which has significantly, affected the programme in the reporting year. This has been caused by delays associated with developers obtaining the necessary planning permissions and also system design changes to accommodate revised customer requirements.

In 2007/08 our non-load capital expenditure of £77m was 15% above allowance. This overspend reflects our focus in maintaining our asset-replacement investment at the level projected in our original Price Control Review submission in order to address identified engineering risk associated with asset condition.

Although we continued to deliver projects originally identified in our Price Control review submission, it is important to note that we are competing in a global marketplace for transmission assets in which demand continues to considerably outstrip supply. This presents considerable challenges in terms of delivery of the capital programme and could lead to some re-phasing of projects going forward.

Gearing/Interest

SPT's borrowing from Scottish Power UK plc has risen by £70 million to £508 million which is in line with expectations. SPT's capital expenditure allowance for 2007-2012 is in excess of £600 million (2004/05 prices) and as a result expenditure is forecast to exceed net cash inflow from operating activities. This will be financed through loans from the parent company.

System Activities and Performances

In terms of system activities and performance, our loss of supply incidents were principally weather related. It is notable that the previous two winters had been very mild; resulting in a lower number of circuit trips, while our performance for 2007/08 was more in line with past historic levels. Our relative low system

availability compared to previous years reflects an increase in planned outages necessary to deliver our construction and asset replacement programme.

Scottish Hydro Electricity Transmission (SHTL)

Table 4.6 SHTL TO

SHTL			
Regulated Income	Allowance	Actual	Timing Difference
	£m	£m	£m
Base Price Control	52.1	51.8	
Difference for income specific inflation	(0.5)		
Under / Over Recovery (Current Year)		1.9	
	51.6	53.7	2.1
Excluded Services		0.8	
Allowed Adjustments			
Timing Differences		(0.1)	
Total Regulatory Turnover		54.4	
Controllable Opex		Actual	
		£m	
Accounting Controllable Opex		5.5	
Non operational capex		0.0	
Total		5.5	
Net movement in provisions / other adjustments (to be recalculated)		0.2	
	Allowance	Actual	Variance
	£m	£m	£m
Cash Controllable Opex	6.2	5.7	0.5
Non Controllable Costs		Actual	
		£m	
Network Rates		3.7	
Tax	Allowance		
	£m		
Current	6.0		
Deferred			
Total P&L Charge			
Innovation Funding Incentive (IFI)	Allowance	Actual	
	£m	£m	
Opex (Allowance = 80% of actual spend)	0.3	0.4	
Logged Up Operating Costs		Actual	
		£m	
Opex		0.0	
Pensions	Allowance	Actual	Under / (Over) Recovery
	£m	£m	£m
Ongoing Costs	1.7	1.0	0.7
Capex (including pensions)	Allowance	Actual	Pensions included in actual
	£m	£m	£m
Load Related	41.0	28.9	0.4
Non Load Related	12.7	14.7	0.2
Subtotal	53.8	43.6	0.6
Capex Not yet Included in RAV			
Logged up capex		0.0	
TIRG		0.6	
Total		44.2	
Incentivised Capex	Allowance	Actual	Variance
	£m	£m	£m
Total capex	53.8	43.6	
less capitalised pensions	(0.9)	(0.6)	
Less net Load related sole use	(8.0)	(9.1)	
Total	44.9	33.9	11.0
Additions		43.6	
Ofgem Adjustments		(0.8)	
Provisional RAV Additions		42.8	
Gearing / Interest (From Debt table)		Actual	
		£m	
Interest Costs (£m)		6.1	
Net Debt		158.1	
Provisional RAV (at year end)		344.3	
Capex not yet included in RAV		0.6	
Gearing as % of provisional RAV and capex not yet included in RAV		45.8%	
System Activities and Performances		Actual	
Overhead Circuit km		5,225	
Underground Circuit km		62	
Measured system maximum demand (GW)		1.7	
Total directly connected generation (GW)		2.7	
Total directly connected wind generation (GW)		0.2	
Total embedded generation (GW)		1.2	
Number of incentivised loss of supply events (#)		10	
System availability		97.7%	
SF6 leakage mass (Kg)		88.0	

LICENSEES COMMENTS

Operating Costs

SHETL has had another stable year as far as Operating Costs are concerned. There was a small under spend on cash controllable Opex costs against the OFGEM allowance. This reflects the continuing tight control of operating costs that exists within SHETL and a number of ongoing efficiency initiatives.

Capital Expenditure

In the second year of TPCR4 SHETL continued to significantly increase Capital expenditure in line with the 2007-2012 agreed OFGEM allowances. Overall capital expenditure has risen by £18.9M in the year.

Load Related Expenditure

Load related expenditure was less than allowance primarily due to delays associated with a number of developer related schemes. However, overall load related expenditure increased from £7.1M to £28.9M in the year. Notable schemes in the year included;

Strathbrora and Millennium wind farms

St Fergus Switching Station

Tealing Static Var Compensation

Non-Load Related Expenditure

Non-Load related expenditure was slightly above allowance for the year but generally in line with programme. Notable schemes in the year included Charleston substation transformers and switchgear replacements, 275kV GA10 switchgear replacements, Sloy/Killin 132kV reconductoring, and Dundee city cable replacements.

5. Amendments to Regulatory Reporting Pack (RRP) Tables

Chapter Summary

This was the second 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 us for 2008/09. Responses to last year's questions are shown in Appendix 1.

→ Questions

- **Question 1: Do you consider relevant Network Output Measures should be published in this report or in the Transmission System Performance Report (under Standard condition C 17 for Electricity)?**
- **Do you consider key data to assist comparisons should be published as part of this report?**
- **Are there any amendments you consider would be helpful?**

Network Output Measures

5.1. As part of TPCR4 the Transmission licensees agreed to propose a methodology for assessing network output (standard condition B17 on electricity and special condition C13 on gas). We expect to incorporate output data in the RRP for 2009/10.

European Transmission Comparisons

5.2. As part of the Network Output Measures the licensees are obliged to assist in international comparisons of transmission performance. The first of these for European Transmission Operators will be published shortly by the EU.

5.3. We propose to add a table to the RRP in 2008/09 to enable these comparisons.

Other Changes

Ofgem propose making the a few minor amendments to the RRP tables in 2008/09 to address points that have arisen during the course of the RRP review. These will be developed over the next few months. We would welcome views on any additional changes that would be appropriate.

Appendices

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Appendix 1 - Responses and Questions

Responses to 2006/07 Transmission Annual Report

Comments from the Transmission Companies

5.4. This appendix summarises the results of our consultation on the first Transmission Annual Report published in April last year (Transmission Annual Report for 2006-07 ref 60/08).

5.5. The transmission companies generally welcome the 2006/07 report and its contents. Some of the companies support the publication of more detail on operating costs although other think the level of detail is about right. Some companies question the need for a summary of income as this is set out in the final proposals and therefore will not change over the price control period. One company was concerned that publication of forecast information (without discussion) as this may conflict with other information published to investors.

Comments from Centrica

5.6. Centrica were the only non transmission company to respond to the Annual Report. Their specific comments were;

- That the report should be published no later than September
- Ofgem should publish the fully populated RRP's from the Transmission companies
- Include an annual forecast and outturn for WACC and Corporation tax rates.

Transmission Companies' Response to Centrica's comments

5.7. Publication in September is unrealistic. We consider that the regulatory and statutory accounts that are published earlier are sufficient. The regulatory accounts purpose is to inform consumers and other interested parties on an annual basis.

5.8. Publication of the entire RRP would not be appropriate as it contains commercially sensitive information. We do not believe that external parties should have nor require access to this level of information

5.9. Tax tables are not the final versions of the computations.

The 2007/08 Report

5.10. We welcome views on the information published in this report. Please send your comments to:

Transmission Cost Review 2006-07

April 2008

Martin Rodgers

Senior Manager, Costs and Outputs Reporting, Transmission

Ofgem

9 Millbank

London

SW1P 3GE

Email: martin.rodgers@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.¹

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 accordingly².

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 them³; and
- The interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.⁴

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:

¹ entitled "Gas Supply" and "Electricity Supply" respectively.

² 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.

³ 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.

⁴ The Authority may have regard to other descriptions of consumers.

- Promote efficiency and economy on the part of those licensed⁵ 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 Regulation⁶ 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.

⁵ or persons authorised by exemptions to carry on any activity.

⁶ 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 2.0) March 2008

Gas Transmission Price Control Review Cost Reporting Rules; Instructions and Guidance (version 2.0) March 2008

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
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk