Transmission Price Control 4 – Scope of the "Adapted Roll-over" (2012-13)

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Target audience: Electricity and Gas Transmission Licensees, Electricity and Gas Distribution Licensees, Generators, Shippers, Suppliers, Customers and other interested parties.

Overview:

The current gas and electricity transmission price controls (TPCR4) expire on 31 March 2012. In October 2009 Ofgem consulted on options for taking forward the next transmission price control review (TPCR5) to enable that review to reflect fully the conclusions of the RPI-X@20 project and other relevant developments in the transmission sector. In December 2009 we published an open letter providing notification of the Authority's decision to implement new price controls from 1 April 2013, while allowing for a one year "adapted roll-over" of TPCR4 for the period from 1 April 2012 to 31 March 2013. We published a document setting out the reasons for this decision in February 2010.

This is a consultation on the scope of the "adapted roll-over". The Authority's decision on this scope will be published after we have considered responses to the consultation.

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Context

The Authority's principal objective in carrying out its functions under each of the Gas and Electricity Acts is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition. Regulation of network monopolies is necessary to protect the interests of consumers.

Regulation of networks encompasses a number of elements including the regulation of network businesses by means of the network price controls. The existing price controls employ incentive-based regulation often referred to as 'RPI-X regulation'. We are currently undertaking a fundamental review of the RPI-X approach under the auspices of our RPI-X@20 project. We are seeking to ensure that the regulatory framework continues to deliver the best results for consumers and is consistent with our other duties, including our duty to facilitate the achievement of sustainable development. We have made it clear that we expect the conclusions from the RPI-X@20 project to be reflected in our approach to the next transmission and gas distribution price controls. We consider it important that any recommendations from the RPI-X@20 project are applied at the earliest stage possible and are not delayed until subsequent transmission price control reviews.

We have therefore decided to delay implementation of Transmission Price Control Review 5 (TPCR5) and to implement a one-year "adapted roll-over" of the existing control (TPCR4). This will enable us to reflect appropriately conclusions from RPI-X@20 project in the next full transmission price control review. The one-year "adapted roll-over" will cover the gap between the expiry of TPCR4 on 31 March 2012 until the implementation of TPCR5 on 1 April 2013.

We have undertaken adapted roll-overs of price controls in the past. We used a similar approach for the transmission companies (the NGET price control was rolled over for one year from 1 April 2006 to 31 March 2007, the two Scottish electricity transmission companies had their price control rolled over first for one year from 1 April 1999 to 31 March 2000 and a second time for two years from 1 April 2005 to 31 March 2007). We also used a similar approach for the gas distribution companies (the GDPCR was rolled over for one year from 1 April 2007 to 31 March 2008). This aligned timetables and created a more even work load for Ofgem, the licensees and the industry.

It is important to ensure our work on price control reviews is proportionate to the length of the control to which the work relates. An adapted roll-over can be different in scope to a usual price control review because it relates to a shorter time period. This consultation document therefore sets out views and invites comments on the scope of the roll-over.

Associated Documents

- Approach and timetable for the next Transmission Price Control Review (TPCR5): decision document (21/10)
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/TPCR5/Documents1/TPCR5%20Approach%20and%20Timetable%20-%20Decision%20Document%20-%20FINAL.pdf
- Approach and timetable options for the next Transmission Price Control Review (TPCR 5): Notice of GEMA decision to delay the implementation of TPCR5 until 2013 and implement a one year adapted roll-over of TPCR4
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/TPCR5/Documents1/FINAL%20-%20TPCR5%20draft%20letter%20of%20notice%20of%20Auth%20Dec%20(sig)%20(2).pdf
- Approach and timetable options for the next Transmission Price Control Review (TPCR5): Consultation (130/09)
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/TPCR5/Documents1/Approach%20and%20timetable%20options%20for%20taking%20forward%20the%20next%20Transmission%20Price%20Control%20Review%20FINAL.pdf
- Regulating energy networks for the future: RPI-X@20 Emerging Thinking - January 2010 (05/10)
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=emerging%20thinking.pdf&refer=Networks/rpix20/publications/CD
- Transmission Access Review – Enhanced Transmission Investment Incentives: Final Proposals (04/10)
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=204&refer=Networks/Trans/ElecTransPolicy/tar

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Summary

Background

The existing transmission price controls, Transmission Price Control Review 4 (TPCR4), cover the five years from 1 April 2007 to 31 March 2012. Running alongside the price control process, the RPI-X@20 project is a detailed review of the future regulatory framework for electricity and gas transmission and distribution networks. We are considering whether the existing frameworks are fit for purpose in terms of meeting the challenges that the energy sector faces. We recently published our 'Emerging Thinking' consultation setting out a potential new regulatory framework and have also published two parallel consultation papers on embedding financeability in a new framework and on the potential introduction of a third party right to challenge price control decisions.

To accommodate better the conclusions of the RPI-X@20 project in the next full transmission price control, we announced on 21 December 2009 that we will be delaying implementation of TPCR5 until 1 April 2013, and will apply a one-year "adapted roll-over" of TPCR4 from 1 April 2012 until 31 March 2012.

Objectives of the adapted roll-over

The scope of an "adapted roll-over" may differ from that of a full price control review due to the shorter time period it covers. It may not be appropriate to review in an "adapted roll-over" all aspects that a full price control would consider. To do so may not be proportionate to the length of the review, not a good use of Ofgem's and the industry's resources, and therefore may neither be in the interest of consumers nor aligned with our statutory objectives.

Accordingly, our intention is that the "adapted roll-over" should have the minimum scope consistent with our duties and the principle of better regulation. We only propose to deviate from this approach to reflect agreed policy developments and/or if there are areas of work we could undertake now which would smooth the path of TPCR5 but which will be independent of the conclusions from the RPI-X@20 project. Consistent with this approach, we may consider new policy issues that are independent from TPCR5 although, at this stage, we have not identified any of such topics for our consideration.

We propose the following objectives will apply to our work on the "adapted roll-over":

- To protect the interests of existing and future consumers wherever appropriate by promoting effective competition – consumer interests are protecting by having high quality transmission networks supporting a high standard of security of supply at an efficient cost[1];
- To be consistent with Ofgem's wider statutory duties, including the need to contribute to the achievement of sustainable development, securing that all reasonable demands for electricity and gas are met, and that licence holders

[1] An Energy Bill is currently being drafted which, in its current format, provides further definition of what the interests of existing and future consumers.

are able to finance their ongoing activities which are the subject of obligations on them;
- To be proportionate to a one-year control and to minimise regulatory burden;
- To reflect recent developments in policy;
- Not to delay critical investment – a large amount of transmission investment is needed in the near future, including to facilitate the achievement of the Government's carbon targets; it is critical that no necessary investment is delayed by our decision to roll over TPCR4 until 31 March 2013; and
- To facilitate an efficient process to develop TPCR5 – we will ensure that the roll-over does not encroach upon decisions to be made in light of the RPI-X@20 project, but will look for areas of non-overlapping work from the roll-over that would enhance the efficiency of tasks at TPCR5.

During TPCR4 we determined both Transmission Owner (TO) and internal System Operator (SO) allowances. Internal SO allowances cover costs such as staff and IT[2]. TO allowances are much more significant in terms of their impact on consumers than internal SO allowances. For this reason, the "adapted roll-over" will primarily be concerned with determining allowances for the TOs.

The table below summarises our current thinking on the approach that would be adopted during the roll-over. We would welcome industry views on our proposal.

Aspect	Proposed approach
Capex	Focus on forecast capex with an investigation of historical capex only where it is necessary to support scrutiny of forecast capex. A complete assessment of historical capex will be undertaken as part of the full price control review.
Opex	Set opex allowances based on the average of costs in the first three years of the control, with consideration of forecast opex and the addition of a company-specific efficiency factor.
Financial Issues	• *Cost of Capital*: update the cost of capital for changes in market assumptions. • *Capitalisation and depreciation*: no change from TPCR4 • *Tax*: reviewing the capital allowance figures and the tax calculation to reflect the changes since TPCR4 but defer any tax claw back for excess gearing until TPCR5 • *Pensions*: adopt the principles established during the review of pension costs as reflected in DPCR5, where possible.
Financeability	Construct a financial model and conduct Rate of Return on Equity (RoRE) analysis as per DPCR5.

Way forward

Following publication of this document we will hold an industry seminar on the one-year "adapted roll-over" in which we will invite comments on our proposed approach. Following this seminar, the Authority will consider all available information, including the responses to the consultation before making its decision on scope.

[2] The companies are incentivised separately (via external SO incentive schemes) in respect of the costs that they incur when balancing the system. The latest SO Incentive schemes are available on our website: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=190&refer=Markets/WhlMkts/EffSystemOps/SystOpIncent

1. Background

Chapter Summary

This chapter sets out the relevant background to transmission price controls, outlines the interactions with the RPI-X@20 project and explains the structure of this consultation.

Question box

No consultation questions relate to this chapter.

Price Controls

1.1. Ofgem believes that competition is often the best mechanism to protect the interests of consumers. However there are areas of the gas and electricity industry where companies retain an effective monopoly and where it may not be possible to introduce competition. This applies to aspects of the transportation of energy to customers over national and local networks of pipes and wires. Here, incentive regulation, such as through price controls, is applied to protect consumers' interests.

1.2. Transmission Price Controls apply to the four electricity and gas transmission companies which own Britain's electricity and gas transmission networks. These are:

- National Grid Electricity Transmission Limited (NGET);
- National Grid Gas Limited (NGG);
- SP Transmission Limited (SPTL); and
- Scottish Hydro-Electric Transmission Limited (SHETL).

1.3. The existing transmission price controls, Transmission Price Control Review 4 (TPCR4), cover the five years from 1 April 2007 to 31 March 2012. An agreement on new revenue allowances will need to be in place for 1 April 2012.

1.4. More detail on price controls in general can be found in appendix 2.

RPI-X@20

1.5. The RPI-X@20 project is our detailed review of the future regulatory framework for electricity and gas transmission and distribution networks. We are considering whether the existing frameworks are fit for purpose in terms of meeting the challenges that the energy sector faces, and in particular meeting the needs of existing and future consumers. We recently published our 'Emerging Thinking' consultation[3] setting out, for consultation, a potential new regulatory framework. We have also published two parallel consultation papers on embedding financeability in a new framework[4] and the potential introduction of a third party right to challenge price control decisions[5].

1.6. In the Emerging Thinking consultation we have signalled the need for the regulatory framework to encourage networks to focus on the needs of existing and future consumers. This will involve contributing to the delivery of a sustainable energy sector and delivering value for money for existing and future consumers. The document includes thinking on a wide range of issues, many of which had also been examined in the working papers published during summer and autumn 2009. These include: developing an output led framework, how to incentivise efficient delivery of desired outputs over the long term, the potential for greater competition in delivery of network services, how to stimulate innovation, how we and networks engage with consumers and network users, and how to ensure efficient delivery is financeable under the framework.

1.7. Responses to the Emerging Thinking consultation are due by 9 April 2010. We will continue to engage with stakeholders and interested parties as our thinking progresses. Our recommendations on the future framework will be made to the Authority in summer 2010 and a decision consulted on in autumn 2010.

1.8. More detail on the RPI-X@20 project is provided in appendix 3.

Process to date

October consultation document on timing of TPCR5

1.9. In October 2009 we published a consultation[6] ('the October consultation') setting out, and seeking views on, two broad options for the timetable and approach for taking forward TPCR5:

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[3] Regulating energy networks for the future: RPI-X@20 Emerging Thinking - January 2010 Ref: 05/10 http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=emerging%20thinking.pdf&refer=Networks/rpix20/publications/CD

[4] Emerging Thinking - Embedding financeability in a new regulatory framework: Parallel Consultation Ref: 6/10 http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/et%20financeability.pdf

[5] Emerging Thinking – Third party right to challenge our final price control decisions: Consultation Ref:14/10 http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/right%20to%20challenge.pdf

[6] Approach and timetable options for the next Transmission Price Control Review (TPCR5): Consultation (130/09) http://www.ofgem.gov.uk/Networks/Trans/PriceControls/TPCR5/Documents1/Approach%20and%20timetable%20options%20for%20taking%20forward%20the%20next%20Transmission%20Price%20Control%20Review%20FINAL.pdf

- **Option 1:** Implement TPCR5 from 1 April 2012, incorporating the conclusions from the RPI-X@20 project, as far as practicable.

- **Option 2:** Implement TPCR5 from 1 April 2013, whilst before that making limited changes to the existing price control regime (TPCR4) so that the regime could be extended for a further year (an "adapted roll-over" of the current regime).

1.10. We indicated a provisional preference for adopting Option 2 – a one year ''adapted roll-over'' of TPCR4. We set out that the main advantage of Option 2 was that it would enable TPCR5 to reflect fully the conclusions of the RPI-X@20 project.

The Authority's decision on timing of TPCR5

1.11. On 21 December 2009 we published a short letter providing notification of the Authority's decision to delay the start of TPCR5 until 1 April 2013. We subsequently published on 15 February 2010[7] a document setting out the reasons for the Authority's decision to delay implementation of TPCR5 and implement a one-year "adapted roll-over" of the existing control (TPCR4). The February document also outlined early thinking on the approach and timetable that will be followed in taking forward TPCR5.

1.12. We recognised that there were advantages and disadvantages associated with each option. The main advantages of Option 1 were that by undertaking the full price control review from 2012 it may enable greater efficiency savings to be passed on to consumers at an earlier stage. Such an approach is also likely to imply a reduced resource burden on the transmission companies and on Ofgem. The key advantages we identified for Option 2 were that it would make it easier to implement improvements to the regulatory framework identified through the RPI-X@20 project, rather than those improvements being delayed until a future regulatory reset. We noted this would provide for a more stable foundation for the development of TPCR5. We expressed our opinion that the long-term advantages of fully reflecting the conclusions of the RPI-X@20 project outweighed any short-term downside.

Previous 'roll-overs'

1.13. Ofgem has previously carried out roll-overs of network price controls. The most recent roll-over was the Gas Distribution Price Control (GDPCR), for which Ofgem decided to reset the revenue allowances that apply to the Gas Distribution Networks (GDNs) for one year from April 2007. This decision was taken to provide a more even workload for companies, Ofgem and industry, allowing gas distribution and transmission issues to be considered separately. The last transmission roll-over sought to align the gas and electricity transmission reviews and involved NGET's electricity transmission control period being extended by one year in 2006 and the

[7] Approach and timetable for the next Transmission Price Control Review (TPCR5): decision document (21/10)
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/TPCR5/Documents1/TPCR5%20Approach%20and%20Timetable%20-%20Decision%20Document%20-%20FINAL.pdf

Scottish transmission companies' controls being extended by two years in 2005 to align with the same date.

Enhanced TO Incentives

1.14. Following completion of the joint Ofgem/Department for Energy and Climate Change (DECC) Transmission Access Review (TAR)[8], we have taken forward work to develop funding arrangements for investment by the electricity transmission owners (TOs) which anticipate future demand from generators. On 19 January 2010 we set out our Final Proposals to facilitate additional investment during the current transmission price control period (TPCR4)[9]. We will fund efficient costs, up to the end of TPCR4, for pre-construction work for all projects and construction work for specific projects. We have provided initial funding under this framework for construction expenditure incurred up to the end of 2011/12, when the current price control expires. Over this period, the TOs currently plan additional investment of around £1bn across all projects, representing around a fifth of the overall £5bn investment programme. We indicated that future funding arrangements, beyond 2011/12, would be considered separately. The treatment of funding beyond 2011/12 is discussed in chapter 3.

1.15. Our January Final Proposals document confirmed the initial tranche of planned investment which we intend to fund at this stage, which amounts to pre-construction expenditure of £78m and construction expenditure of £241m in 2010/11 for projects planned to commence construction prior to 1 April 2011. We will assess further funding, including additional projects, when this funding is required and the necessary information is available.

This document

1.16. The remainder of this document is structured as follows:

- Chapter 2 discusses the objectives of the one-year "adapted roll-over".
- Chapter 3 sets out our thoughts on its scope regarding issues such as efficiency assessments for capital and operating expenditure, the inclusion of new transmission policy issues and our ideas on stakeholder engagement throughout our work on the one-year "adapted roll-over".
- Chapter 4 covers financial issues.
- Our views on next steps and the way forward in general are set out in chapter 5.

[8] More information on TAR is available on Ofgem's website: http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Pages/Traccrw.aspx
[9] Transmission Access Review – Enhanced Transmission Investment Incentives: Final Proposals (04/10) http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=204&refer=Networks/Trans/ElecTransPolicy/tar

1.17. All consultation questions and instructions on how to respond to this consultation document are set out in Appendix 1. We encourage stakeholders to provide feedback particularly on the questions set out in that appendix and at the beginning of each chapter, but also welcome any general comments that may be made. Further appendices include additional information on price controls, the Authority, the RPI-X@20 project, a Glossary and a Feedback Questionnaire.

2. Objectives

Chapter Summary

This chapter sets out and consults on the objectives we intend to pursue in the one-year "adapted roll-over".

Question box

Question 1: Do you agree with the objectives for the one-year "adapted roll-over" set out in this chapter? Are there additional objectives that should be included?

2.1. Our intention is that the "adapted roll-over" should have the minimum scope consistent with our duties and the principle of better regulation. We consider that this will ensure that the "adapted roll-over" represents a proportionate intervention that minimises the risk of making decisions which are inconsistent with the conclusions of the RPI-X@20 project. We only propose to deviate from this approach:

- To reflect agreed policy developments; and/or
- If there are areas of work we could undertake now which would smooth the path of TPCR5 but which will be independent of the conclusions from the RPI-X@20 project.

2.2. We propose that the objectives of the "adapted roll-over" should be as follows:

- **To protect the interests of existing and future consumers[10] wherever appropriate by promoting effective competition** – Consumers' interests are protected by having high quality transmission networks supporting a high standard of security of supply delivered at an efficient cost. Therefore, while the review is a 'roll-over' it should provide an appropriate level of scrutiny of transmission companies' forecasts, sense-checked against their historical performance.

- **To be consistent with Ofgem's wider statutory duties** – including the need to secure that licence holders are able to finance their ongoing activities which are the subject of obligations on them. When carrying out our duties we also have regard to the need to contribute to the achievement of sustainable development and to the effect on the environment from regulated activities. We also have regard to the need to secure that all reasonable demands for electricity and gas can be met. The Authority shall also have regard to statutory

[10] An Energy Bill is currently being drafted which, in its current format, provides further definition of what the interests of existing and future consumers.

guidance on social and environmental matters issued by the Secretary of State. A revised version of its Social and Environmental Guidance was formally issued to the Authority on 18 January 2010.

- **To be proportionate to a one-year control and to minimise regulatory burden** – Recognising that the proposals will only apply for one year and that the review will extend the existing control mechanisms, the review should not introduce fundamentally different arrangements relative to the preceding price control. To develop new arrangements in the year before the introduction of the new framework (resulting from the RPI-X@20 project) would create greater uncertainty and undermine the purpose of the "adapted roll-over". Our approach should also seek to maximise administrative efficiency in terms of the resource requirements and costs of both Ofgem and the industry. Relevant considerations include the number of consultation papers published and the requirement for consultancy support.

- **To reflect recent developments in policy** – There have been a number of areas where changes have been made to the process for calculating key price control parameters in the period since the final decisions for TPCR4. For example, Ofgem has recently completed a review of the treatment of pension costs that will affect all future network price controls and in setting DPCR5 Ofgem gave consideration to the cost of capital. The DPCR5 process also built in arrangements for greater stakeholder engagement. In addition, there is a need to update certain price control parameters, for example, the revenue drivers in light of: (a) our work on TO incentives work; and (b) the Connect and Manage access regime which is expected to be implemented by Government, to appropriately reflect the relationship between investment and the volume of generation connected. While it may be disproportionate to reflect all changes in policy in the one year "adapted roll-over", any proposal for the "adapted roll-over" should be considered in the context of avoiding inconsistency with recent developments in policy.

- **Not to delay critical investment** – A large amount of transmission investment is needed in the near future, including facilitating the achievement of the Government's carbon targets. For electricity, this investment has been highlighted in a study by the Electricity Networks Strategy Group[11], and we accept that requirements for additional investment may be identified. It is critical that no necessary investment is delayed by our decision to roll over TPCR4 until 31 March 2013.

- **As far as practical, to enable an efficient process to develop TPCR5** – Whilst we intend to manage the "adapted roll-over" as a distinct exercise, separate from our work on TPCR5, we recognise that there may be an interaction with work that would subsequently have to be taken forward as part of TPCR5. We will ensure that the roll-over does not encroach upon decisions that will be made in the light of the RPI-X@20 project, however, we will look for areas where

[11] The ENSG study is available on the ENSG website: http://www.ensg.gov.uk/assets/ensg_transmission_pwg_full_report_final_issue_1.pdf

non-overlapping work undertaken as part of the "adapted roll-over" will either remove or reduce the need to perform certain tasks as part of TPCR5.

2.3. We would welcome comments from interested parties on these objectives.

3. Scope of the "adapted roll-over": general approach

Chapter Summary

This chapter sets out and consults upon our proposed scope for the one-year "adapted roll-over".

Question box

Question 1: Do you agree with our intention to include TO and SO components in the one-year "adapted roll-over"?
Question 2: Do you agree with the three options we have identified regarding the treatment of capex? Do you agree with our 'minded to' position i.e. option 2?
Question 3: Do you agree with the four options we have identified regarding the treatment of opex? Do you agree with our 'minded to' position i.e. option 3?
Question 4: Do you support our intention not to pursue new policy issues as part of the one-year "adapted roll-over"? In particular, do you agree with our position not to assess in the "adapted roll-over" those projects that were nominated under the Enhanced TO Incentives project?
Question 5: Regarding revenue drivers, do you agree that no new regulatory incentives should be introduced and that the existing targets should be simply rolled-forward with the exception of any adjustments to address areas where there has been significant misalignment between TPCR4 baselines and outturn values?
Question 6: Do you agree with our 'minded to' position to extend the application of the existing network output measures methodology for the one-year "adapted roll-over"?
Question 7: Do you agree with our 'minded to' position to restrict licence amendments to those required to facilitate execution of the "adapted roll-over" and for any rationalisation process to take place as part of TPCR5?
Question 8: Do you agree with our proposals regarding the engagement of stakeholders? Do you have any suggestions for additional ways which we should pursue to improve stakeholder engagement?
Question 9: Do you have any further comments on the general scope of the one-year "adapted roll-over"?

3.1. This section provides an overview of the proposed scope of the one year "adapted roll-over". It sets out an overview of options on the scope of the "adapted roll-over" on which we propose to consult and indicates our current thinking on the "adapted roll-over". In approaching previous roll-overs we have taken the view that a simplified approach was proportionate with undertaking a one-year review. We continue to hold this view but consider it important that the level of regulatory scrutiny is consistent with our primary duty of protecting the interests of existing and future consumers and with promoting sustainable development and our other duties.

Overall scope – TO and SO components

3.2. During TPCR4 we determined both Transmission Owner (TO) and internal System Operator (SO) allowances. Internal SO allowances cover internal costs such as SO staff and IT. The companies are incentivised separately (via external SO incentive schemes) in respect of the costs that they incur when balancing the system. TO allowances are much more significant in terms of their impact on consumers than internal SO allowances. For this reason, although we anticipate the need to consider internal SO costs, the “adapted roll-over” will primarily be concerned with determining allowances for the TOs. For the assessment of the SO’s opex, we intend to adopt the same broad approach as for the TOs.

Capex

3.3. The assessment of historical and forecast capex is a key part of any price control process. The assessment of **historical capex** is valuable in providing relevant evidence which can inform judgements about the validity of companies’ forecast capex and is an important input to the setting of the opening Regulatory Asset Value (RAV) for the new price control period. In undertaking previous roll-overs Ofgem has reviewed capex to different extents:

- In the GDPCR roll-over, Ofgem reviewed capex in detail because, at the time, it was considered there was a strong case for carrying out a detailed review of historical capital and replacement expenditure; whereas
- During the previous transmission roll-over, Ofgem undertook a more limited review of capex, supported by an assessment by consultants. Ofgem used the output of this limited review to determine an interim RAV. At the subsequent full price control review, adjustments were made to the interim RAV, following a more detailed capex review.

3.4. In previous roll-overs we have undertaken a review of the **forecast capex** information which the TOs provided as part of their business plans and Regulatory Reporting Pack (RRP) returns. We carried out this review to ensure that efficient investment could proceed during the relevant period without placing a significant financial burden on the TOs. This has required a level of scrutiny given that transmission investment is normally infrequent, significant and unlikely to follow a trend that can be established from historical analysis.

3.5. We consider there are three options for determining the treatment of capex under the “adapted roll-over”.

- **Option 1** – Focus on forecast capex with no investigation of historical capex. This option would use only forecast information from licensees in determining capex allowances and would not consider historical capex information. This option is least burdensome for Ofgem and the licensees. However, it carries the risk that inefficiently incurred expenditure is not identified during the current period. This could result in capex allowances being set which are not reflective of requirements, resulting in unjustified costs to consumers or, conversely, insufficient capex allowances for licensees. Under this approach, a full capex review would be carried out at TPCR5 and revenue allowances would be adjusted accordingly.

- **Option 2** – Focus on forecast capex with a limited investigation of historical capex to support the evaluation of forecast capex. This is similar to option 1 but would allow for the use of some historical capex information in determining capex allowances. It will place slightly more regulatory burden on Ofgem and licensees but should reduce the risk of inappropriate capex allowances being set. The outputs from any historical capex analysis could be used to expedite our work for TPCR5. Again, under this approach, a full capex review would be carried out at TPCR5 and revenue allowances would be adjusted accordingly.

- **Option 3** – Full formal/in-depth assessment of historical and forecast capex. This option will place most burden on Ofgem and the licensees but should have the least risk in terms of inappropriate capex allowances being set. The outputs from such a full review can be used at TPCR5 which creates efficiencies.

3.6. The pros and cons of these options are summarised in Table 1.

Table 1 - Capex options for the one year "adapted roll-over"

	(1) Focus on forecast capex – no investigation of historical capex	**(2) Focus on forecast capex with investigation of historical capex to support evaluation of forecast capex**	**(3) Full formal/in-depth assessment of historical and forecast capex**
Protecting consumers	✗	✓ / ✗	✓
Wider statutory duties (including licensee funding)	✗	✓ / ✗	✓
Proportional to a one year control	✓	✓	✗
Efficiency in developing TPCR5		✓ / ✗	✓

3.7. Table 1 highlights the way in which we expect the different options for treatment of capex under the "adapted roll-over" to impact on the various objectives that we set out in chapter 2. We do not consider that the treatment of capex will have any impact on the objectives of reflecting recent developments in policy or in not delaying investments, as there is a parallel project on enhanced TO incentives the aim of which is to ensure critical investment is not delayed by funding considerations.

3.8. ***In light of the pros and cons of the capex options set out in table 1 we are minded to adopt Option 2 - focusing on forecast capex with an investigation of historical capex only where it is necessary to support this forward-looking assessment.*** We consider that this approach represents an efficient use of resources prior to the commencement of TPCR5. Option 2 would not allow us to assess the efficiency of historical capex spend in depth for the purposes of the "adapted roll-over". However, we would be able to do this and to make suitable adjustments at TPCR5[12].

Opex

3.9. A detailed assessment of opex generally involves using a combination of bottom-up cost analysis of specific activities, and top-down benchmarking of total opex. In previous roll-overs we have generally adopted a simplified approach to our assessment of opex. In some cases we have carried forward existing price control allowances adjusted for inflation; in others we have adopted an approach which involves allowing a level of costs which is equal to the level of actual costs in the last year of the previous price control period. Regardless of the approach adopted we have previously considered adjustments to reflect efficiency savings.

3.10. We consider there are four options for determining the treatment of opex under the "adapted roll-over":

- **Option 1 -** TPCR4 Opex allowance rolled-over**.** This option assumes that opex during the "adapted roll-over" year would be similar to TPCR4 and does not require a review of actual performance or forecasts. This option is least burdensome for Ofgem and the licensees, but carries the risk that we set inappropriate opex allowances which may result in unjustified costs to consumers or create financial strain for the companies.
- **Option 2** - Opex rolled forward based on average of actual costs, for example, for the first three years of the current control. This is similar to option 1, but more likely to reflect actual opex requirements.
- **Option 3** - Opex rolled forward based on average of costs in, for example, the first three years of the current control with the addition of an efficiency factor on a company specific basis. Such an efficiency factor would reflect an expectation of how opex may change during 2012/13, based on the company's opex expenditure and performance during the beginning of TPCR4.
- **Option 4** - Full top down and bottom up assessment of opex. This is the approach we would adopt in a full price control review.

3.11. The pros and cons of these options are summarised in Table 2.

[12] If there were such adjustments, revisions would need to be made to the calculation of the capex roller in Appendix 2 and 7 of the TPCR4 final proposals.

Table 2 - Opex options for the one year "adapted roll-over"

	Option 1 – Opex allowance roll-over	**Option 2 – Opex allowance rollover with consideration of forecast**	**Option 3 – Opex allowance rollover with consideration of forecast and efficiency factor**	**Option 4 – full Opex assessment**
Protecting consumers	✗	✓ / ✗	✓	✓
Wider statutory duties (including licensee funding)	✗	✓ / ✗	✓	✓
Proportional to a one year control	✓	✓	✓ / ✗	✗
Efficiency in developing TPCR5				✗

3.12. Table 2 highlights the way in which we expect the different options for treatment of opex under the "adapted roll-over" to impact on the various objectives that we set out in chapter 2. We do not consider that the treatment of opex will have any impact on the objectives of reflecting recent developments in policy or not delaying investments.

3.13. We are currently of the view that a detailed assessment of opex is not appropriate for the "adapted roll-over". However, reflecting the potential for significant variances from opex allowances we also have concerns that an overly simplistic approach would not be in the best interest of consumers. ***We are therefore minded to adopt Option 3 – Opex rolled forward based on average of costs in up to the first three years of the control with a consideration of forecast opex and the addition of an efficiency factor on a company specific basis.***

Transmission Policy

3.14. In the past we have sought to develop new policy during full price controls. For example, during TPCR4 we introduced the Innovation Funding Incentive (IFI) and an incentive to encourage transmission companies to reduce the leakage of sulphur hexafluoride (SF_6), a potent greenhouse gas used in high voltage apparatus (SF_6 incentive).

3.15. We have ongoing workstreams dealing with different aspects of transmission policy, for example work relating to the Transmission Access Review (TAR) and the Gas Transmission Entry Charging Review. We are committed to progressing this work, some of which is time critical and at the core of our statutory duties, including the need to contribute to the achievement of sustainable development.

3.16. Our work on Enhanced TO Incentives falls into the category of ongoing policy work. In our Enhanced TO Incentives Final Proposals document[13] we expressed no preference regarding interactions with the "adapted roll-over". We will continue to advance proposals on the funding of critical investments in a way that is aimed to avoid any delay to these projects, and will manage this work separately to the "adapted roll-over" exercise. Our proposed way forward regarding a potential extension of the Enhanced TO Incentives mechanism will be set out in due course. For the avoidance of doubt, any capex assessment for 2012/13, unrelated to our enhanced TO Incentives work, will be made within the "adapted roll-over". Eventually, those projects assessed under the Enhanced TO Incentives mechanism as well as those projects assessed under the "adapted roll-over" will be captured in TPCR5 and regulated under a regime consistent with the conclusions of the RPI-X@20 project.

3.17. We consider that developing and implementing new and detailed changes to policy for a one-year control is disproportionate. It would also not reflect the justification for a one-year roll-over which is that the RPI-X@20 project may result in significant changes, many of which would not be possible to reflect fully in such a short timeframe. However, stakeholders may consider that certain policy issues should not be delayed to TPCR5.

3.18. ***We are committed to pursuing existing, parallel policy work, however, we do not consider there are any new policy issues that need to be addressed as an integral part of the "adapted roll-over". We seek stakeholders' views on this position.***

3.19. Some transmission policy aspects of the current price control need to be modified for the "adapted roll-over". A suite of revenue drivers and incentives for the electricity and gas licensees were set as part of TPCR4. These include rules for the automatic adjustments to revenue in the light of changing patterns of demand for network capacity and also incentive schemes for system performance and to support innovation. Some of these, for example in electricity the local driver Unit Cost Allowances (UCAs), will need to be updated because they need to be set for the additional year of the "adapted roll-over". Other parameters will need to be updated to reflect major changes (such as the relationship between generation volume and investment, including consideration of the impact of the application of a Connect and Manage access regime). Furthermore, we recognise there may be specific areas where assumed TPCR4 baselines or parameters are materially misaligned with outturn values. We do not intend to reset any of the gas revenue drivers that were set at or after TPCR4. The regime for gas transmission revenue drivers for incremental entry capacity signalled at auctions prior to April 2007 requires that an adjustment be made to the relevant RAV at the first price control review following contractual delivery of the capacity. It is intended that this adjustment will follow an

[13] Transmission Access Review – Enhanced Transmission Investment Incentives: Final Proposals (04/10) http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=204&refer=Networks/Trans/ElecTransPolicy/tar

efficiency assessment. A further adjustment is required at the subsequent price control review. As a consequence, the regime envisaged that adjustments would be made to the RAV on 1 April 2012 for a number of incremental entry capacity signals. However, if we decide to determine capex allowances from forecast capex with only a limited investigation of historic capex only we will not be able to assess the efficiency of historic capex spend in depth. Therefore, any efficiency assessment of capex spend on incremental entry capacity will be conducted at TPCR5 and any adjustments that may be required will be made on a *retrospective* basis from 1 April 2012.

3.20. At TPCR4, standard condition B17: Network Output Measures was inserted into the Electricity Transmission Licence requiring licensees to develop a network output measure methodology for approval and subsequent implementation. NGG also has output measures in relation to system reliability and obligated capacity. The purpose of developing output measures is to enable greater visibility of the performance of the transmission systems in response to the licensees' allowed capex and opex. Creating an outcomes-led framework is one of the key features of the RPI-X@20 project. Putting much greater focus on the delivery of outcomes and outputs related to safe, secure, high quality and sustainable network services at value for money is one of the core objectives set out in the RPI-X@20 Emerging Thinking document. Changing the approach on output measures in the "adapted roll-over" would carry the risk of creating inconsistencies with the RPI-X@20 project and ultimately TPCR5. We therefore propose to simply extend the agreed output measures methodology by one year.

3.21. We propose to restrict licence amendments to those amendments which are required to facilitate execution of the "adapted roll-over" and for any rationalisation process of licences to take place as part of TPCR5. We consider that no new regulatory incentives should be introduced and that the existing targets should be simply rolled-forward with the exception of any adjustments to address areas where there has been significant misalignment between TPCR4 baselines and outturn values. However, some price control parameters in the licences are time specific and will expire on 31 March 2012. These parameters will need to be defined and/or updated during the "adapted roll-over". The existing licence drafting is complex (particularly the gas licence) and we consider that a licence rationalisation process should be undertaken. However, to undertake a rationalisation process would require significant resource.

3.22. We propose to extend the application of the existing network output measures methodology for the one-year "adapted roll-over".

Stakeholder Engagement

3.23. It is extremely important that we engage effectively with our stakeholders, particularly consumers and users of the networks, during price control processes. In delivering DPCR5, we introduced an 'enhanced' level of interaction and consultation and we intend to continue this approach during our work on the one-year "adapted roll-over".

3.24. In undertaking stakeholder consultation throughout the "adapted roll-over", we will take into consideration the project objectives (outlined in Chapter 2) and pay particular attention to ensuring that interactions promote the interest of consumers (by engaging them in the process); are proportional to the one-year control and ensure an efficient transfer into TPCR5, while minimising confusion between the two processes.

3.25. In line with our objectives and taking forward the approach and lessons learned in DPCR5 we intend to adopt the engagement practices below during the "adapted roll-over". We will also be encouraging the TO's to become actively involved in the stakeholder engagement and interaction process.

Ofgem-led workshops

3.26. We intend to run a number of Ofgem-led workshops - with assistance from the TOs – that will be open for all interested parties to attend. The aim of these workshops is to provide an opportunity for further discussion on key elements of the review.

3.27. The first workshop will take place on 13 April 2010 and provide an opportunity to discuss the objectives and scope presented in this paper.

Challenge Groups

3.28. Building on the DPCR5 approach we intend to engage a Consumer Challenge group consisting of expert consumer representatives who will act to advise and challenge the project team and Committee of the Authority.

Bilateral meetings

3.29. To ensure that both ourselves and our stakeholders are informed throughout the process, we will engage individuals, groups and agencies at times for bilateral discussions. These meetings will provide an opportunity for detailed discussion on specific matters and will welcome requests from interested parties.

Panels and working groups

3.30. Previous price controls have demonstrated the benefits of utilising working groups to discuss and develop views on key issues and areas of analysis. We intend to follow this approach and will provide further details on working group membership in due course.

4. Scope of the "adapted roll-over": Financial Issues

Chapter Summary

This chapter sets out and consults upon our proposed scope for the one-year "adapted roll-over".

Question box

Question 1: Do you agree with our intention to use an enhanced version of the TPCR4 financial model following developments embodied in the GDPCR and DPCR5 models for the "adapted roll-over"?
Question 2: Do you agree with our intention to use RoRE analysis for the "adapted roll-over" to ensure the package as a whole is appropriate?
Question 3: Do you agree with the three options we have identified regarding the treatment of the cost of capital and our 'minded to' position i.e. option 2?
Question 4: Do you agree with the two options we have identified regarding the treatment of capitalisation & depreciation and our 'minded to' position for option 1?
Question 5: Do you agree with the three options we have identified regarding the treatment of tax and our 'minded to' position i.e. option 2?
Question 6: Do you agree with the three options we have identified regarding the treatment of Pensions? Do you agree with our 'minded to' position i.e. option 2?
Question 7: Do you have any further comments regarding financial issues for the one-year "adapted roll-over"?

Financial model

4.1. As with previous price control reviews, we will construct a financial model to test the ongoing financeability of the TOs. We intend to amend the model developed for TPCR4 following the developments which were embodied in the last gas distribution and electricity distribution price control reviews. We recognise that this model may require further development for TPCR5 in light of the conclusions of the RPI-X@20 project.

Return on Regulated Equity (RoRE)

4.2. During DPCR5 we used the RoRE measure as a tool to assess the range of equity returns that investors might be able to earn from the price control package as a whole. RoRE analysis consists of both historical and projected elements. We intend to use RORE analysis for the "adapted roll-over" to ensure the package as a whole is appropriate.

Cost of capital

4.3. The rate of return allowed under TPCR4 was a vanilla Weighted Average Cost of Capital (WACC) of 5.05%. The recent DPCR5 proposals have determined a WACC of 4.7% for the electricity distribution businesses (equivalent to a vanilla WACC of 4.84% when adjusted to adopt a gearing ratio of 60% as per TPCR4[14]). In previous roll-overs rather than undertaking a full review of the cost of capital calculation, we have reviewed the assumptions with respect to the cost of debt and equity finance as well as the level of gearing. This has typically not been as comprehensive as a full review.

4.4. We consider there are three options for determining the cost of capital under the “adapted roll-over”:

- **Option 1** – TPCR4 WACC rolled-over for a further year. Whilst this is the least burdensome option, it carries the risk that the cost of capital allowance for the “adapted roll-over” will not reflect the actual market conditions faced by licensees, which may impact on the companies’ financeability or not provide value for money to consumers.
- **Option 2** – Conduct a high-level review of WACC which would seek to identify any material changes to inputs. Where the movement in inputs is sufficiently large we would then carry out a more comprehensive review of the relevant input. This option would protect consumers’ interests and should assist the companies’ financeability whilst avoiding unnecessary duplication with the work that will be conducted on cost of capital allowances for TPCR5.
- **Option 3** - Full review and resetting of WACC (including true-up of equity issue costs)[15]. This option is most likely to generate the most appropriate cost of capital allowance for the “adapted roll-over”, but may not be appropriate for a one–year “adapted roll-over” due to the resources it requires from Ofgem and the licensees.

4.5. The pros and cons of these options are summarised in Table 3.

4.6. Table 3 highlights the way in which we expect the different options for determining the cost of capital under the “adapted roll-over” to impact on the various objectives that we set out in chapter 2. We do not consider that the determination of the cost of capital will have any impact on the objectives of not delaying investments or facilitating an efficient process to develop TPCR5.

4.7. Given our primary duty to protect existing and future consumers, the potential materiality of cost of capital and the need to avoid an excessive regulatory burden for a one-year “adapted roll-over” ***we are minded to adopt Option 2 - Update for changes in market assumptions with a high level review of all other inputs to the WACC calculation with further analysis and update only where justified change.***

[14] With no adjustment to the leveraged beta.
[15] The true-up is the adjustment for the difference between the allowance and the actual expenditure in the previous price control.

Table 3 - Cost of capital options for the one year "adapted roll-over"

	Option 1 – Roll-over of TPCR4 WACC	**Option 2 – High-level review of WACC**	**Option 3 – Reset WACC fully**
Protecting consumers	✗	✓ / ✗	✓
Wider statutory duties (including licensee funding)	✗	✓ / ✗	✓
Proportional to a one year control	✓	✓ / ✗	✗
Reflect recent developments in policy	✗	✓	✓

Capitalisation and depreciation

4.8. The capital intensive nature of transmission businesses means that revenue allowances are set to ensure that costs are recovered over the assumed regulatory life of the assets. Recognising that transmission assets deliver services to customers over a number of years, price controls provide allowances for depreciation and return on RAV. The policies adopted for capitalisation and depreciation can have a significant impact on the revenues of a company in any particular price control. In TPCR4 our *capitalisation policy* followed that of each TO. We adopted a 'tilting' approach for *depreciation* for all electricity transmission companies whereby, once pre-Vesting assets became fully depreciated, we reduced post-Vesting regulatory asset lives to 20 years, with company-specific smoothing adjustments in relation to post-Vesting assets already installed. Gas transmission uses straight-line depreciation over 45 years, which is the same as gas distribution.

4.9. In our most recent price control, DPCR5, we used a similar depreciation policy as that used for electricity transmission but introduced a significantly different capitalisation policy. We moved to a regime where all costs whether classed as opex or capex (but excluding business support and non-operational capex) were grouped together to form totex. Each year, 85% of totex was added to the RAV and the balance was funded in the year of expenditure as with business support and non-operational capex costs.

4.10. We consider there are two options for the treatment of capitalisation and depreciation under the "adapted roll-over":

- **Option 1** - No change from TPCR4 treatment of capitalisation and depreciation. This has the minimum regulatory burden on Ofgem and licensees, however, it could potentially allow TOs to generate revenues that do not reflect current requirements.

- **Option 2** - Full review of capitalisation and depreciation policy. In DPCR5, as mentioned above, we introduced a change to the DNOs regulatory capitalisation policy. In undertaking a full review we would consider whether or not this was appropriate for the TOs or whether some other form of common policy was appropriate. The depreciation lives of electricity TOs is different to that used in gas. In reviewing the policy we would assess whether the current depreciation lives and tilting of depreciation, where used, are appropriate to each type of business. This is potentially the most accurate way of determining TO revenue allowances when considering capitalisation and depreciation, however, we consider that this would be disproportionate to a one year roll-over and place greater regulatory burden on Ofgem and licensees. In addition, capitalisation and depreciation are being considered in detail as part of the RPI-X@20 financeability workstream and it would be inappropriate to also review as part of the one year "adapted roll-over".

4.11. The pros and cons of these options are summarised in Table 4.

Table 4 - Capitalisation & depreciation options for the one year "adapted roll-over"

	Option 1 – No change from TPCR4	**Option 2 – Full review**
Protecting consumers	✓ / ✗	✓
Wider statutory duties (including licensee funding)	✓ / ✗	✓
Efficiency in developing TPCR5	✓ / ✗	✗
Proportional to a one year control	✓	✗

4.12. Table 4 highlights the way in which we expect the different options for the treatment of capitalisation and depreciation policies under the "adapted roll-over" to impact on the various objectives that we set out in chapter 2. We do not consider that the treatment of capitalisation and depreciation policies will have any impact on the objectives of reflecting recent policy developments or not delaying investments or facilitating an efficient process to develop TPCR5.

4.13. We consider that any changes to the treatment of capitalisation and depreciation during a 1 year price control period are likely to foster greater uncertainty, particularly as these issues are being considered as part of the

RPI-X@20 project. Therefore ***we are minded to adopt Option 1 - no changes from TPCR4 to the treatment of capitalisation and depreciation for the "adapted roll-over".***

Tax

4.14. The cost of expected tax payments is factored into allowed revenues. In undertaking previous roll-overs we have considered it disproportionate to undertake detailed work to determine specific tax liabilities. However, we note that work has recently been undertaken on the treatment of tax for DPCR5 and consider it important to reflect such recent developments. Further, to the extent that there are any mandatory changes to the tax rates and rules we consider that these should be reflected in the review. However, we do not consider that the introduction of policy changes, such as the tax trigger[16] that was implemented as part of DPCR5, would be consistent with the principles for the one-year "adapted roll-over" set out in this document.

4.15. We consider there are three options for the treatment of tax under the "adapted roll-over":

- **Option 1** – Calculate tax using each TO's effective tax rate in recent years (defer tax claw-back). This is proportionate to a one-year roll-over. However, this method may give rise to significant estimation errors unless considerable effort is incurred to obtain an improved estimate which is not a straightforward process and could incur significant regulatory burden..
- **Option 2** - Review expected tax costs using appropriate capital allowances, current tax rates and the form of tax calculation used in DPCR5 (defer tax claw-back). This allows a better reflection of actual tax costs than option 1, would reflect recent changes in tax rates, capex and pensions expenditure and the analysis can be used for TPCR5. It should not result in a significant additional workload (as the model currently uses a full calculation) so is proportionate to a one-year roll-over. However, it provides less accurate treatment of tax than under a full review.
- **Option 3** - Review expected tax costs using appropriate capital allowances, current tax rates and the form of tax calculation used in DPCR5 and including claw-back for excess gearing. This is the most accurate treatment of tax and the analysis could be used for TPCR5. However, it would be disproportionate for a one-year roll-over to incur such significant regulatory burden.

4.16. These options and their pros and cons are summarised in Table 5.

[16] This mechanism was introduced in DPCR5 and triggers a revenue adjustment under certain circumstances to reduce the risk to DNOs from material changes in tax payments beyond their control arising from, for example, legislative change.

Table 5 - Tax options for the one year "adapted roll-over"

	Option 1 – Use effective tax rate, defer claw-back	Option 2 – Review tax costs using capital allowances, defer claw-back	Option 3 – review tax costs using capital allowances and claw-back for excess gearing
Protecting consumers	✗	✓ / ✗	✓
Wider statutory duties (including licensee funding)	✗	✓ / ✗	✓
Proportional to a one year control	✓	✓	✗
Reflect recent developments in policy	✗	✓	✓
Efficiency in developing TPCR5		✓	✓

4.17. Table 5 highlights the way in which we expect the different options for the treatment of tax under the "adapted roll-over" to impact on the various objectives that we set out in chapter 2. We do not consider that the treatment of tax will have any impact on the objective of not delaying investments.

4.18. In light of the pros and cons set out above ***we are minded to pursue Option 2 - adopting an approach involving reviewing the capital allowance figures and the tax calculation to reflect the changes since TPCR4 but deferring any tax claw back for excess gearing until TPCR5.***

Pensions

4.19. Pension costs are factored into allowed revenues. Pensions costs have only been considered separately to operating costs since 2004. In the GDPCR 2006/07 review we revised allowances to reflect recent actuarial reviews.

4.20. During 2008 and 2009 Ofgem undertook a review of the treatment of pension costs affecting all network operators. The conclusions of this review were used to set allowances for DPCR5. The DPCR5 Final Proposals document made it clear that the decisions in DPCR5 would also apply, in general, to other network operators in future reviews. We also undertook to issue a further document, in 2010, to provide additional clarity as to how the conclusions would affect transmission and gas distribution.

4.21. Pension costs can be divided into three broad categories for price control purposes: on-going costs, deficit repair costs and true-up adjustments. For on-going costs the broad conclusion of the pensions review was that benchmarking should be an important factor in setting allowances. However, we do not consider it will be practical to implement this for the "adapted roll-over" because, as with DPCR5, we do not consider we will be able to undertake detailed opex benchmarking in time for the 1 year "adapted roll-over". In respect of deficit repair costs the conclusions of the pensions review (i.e. in summary to use latest valuations and a 15-year deficit repair) could be applied. The true-up adjustments could be made for the one year "adapted roll-over" but would require substantial effort to review the efficiency of the relevant schemes.

4.22. We consider there are three options for the treatment of pensions under the "adapted roll-over":

- **Option 1** - Roll-forward TPCR4 allowances for 1 year (ongoing costs), use updated valuations and apply TPCR4 recovery period of 10 years (deficit costs), no true-up from TPCR4. This is the most straightforward process and therefore is proportionate with a one-year roll-over. However, it would not reflect changes following the pensions review and DPCR5 and could result in inappropriate pension allowances and may therefore be inconsistent with our primary duty to protect customers.
- **Option 2** – Review pension costs by, where appropriate, reflecting conclusions from pensions review, no true-up from TPCR4. This would primarily entail an update to the costs associated with deficit repair funding by for example using latest funding valuations, updated regulatory fractions and the deficit repair period resulting from the review of pensions. This is a more accurate reflection of costs than option 1 through its reflection of relevant changes in DPCR5 and the pension review, so would better protect consumers and meet our wider statutory duties. The analysis could also be used for TPCR5, however, this may be disproportionate to a one-year review.
- **Option 3** - Review pension costs by, where appropriate, reflecting conclusions from pensions review and apply true-up mechanism from TPCR4. This option would update the costs associated with deficit repair funding as in option 2. In addition, it would provide for the correction of differences between the allowances set in TPCR4 and the actual costs incurred by the TOs over this period. This is a more accurate treatment of pension costs and the analysis could be used for TPCR5. However, the additional resource requirement to perform external reviews of each pension scheme using the Government Actuary Department to perform an efficiency review would increase the regulatory burden and would potentially be disproportionate to a one-year review.

4.23. The pros and cons of these options are summarised in Table 6.

Table 6 - Pensions options for the one year "adapted roll-over"

	Option 1 – Roll forward allowances, use updated valuations, apply TPCR4 recovery period, no true-up	**Option 2 – Review pension costs, where appropriate, reflecting pensions review conclusions, no true-up**	**Option 3 - Review pension costs, where appropriate, reflecting pensions review conclusions, apply true-up**
Protecting consumers	✗	✓	✓
Wider statutory duties (including licensee funding)	✗	✓	✓
Proportional to a one year control	✓	✓/✗	✗
Reflect recent developments in policy	✗	✓	✓
Efficiency in developing TPCR5		✓	✓

4.1. Table 6 highlights the way in which we expect the different options for the treatment of pensions under the "adapted roll-over" to impact on the various objectives that we set out in chapter 2. We do not consider that the treatment of pensions will have any impact on the objective of not delaying investments.

4.2. In light of the assessment set out above ***we are minded to adopt Option 2 - that the principles established during the review of pensions' costs, as reflected in DPCR5, should be reflected where possible for the "adapted roll-over".***

5. Way Forward

Chapter Summary

This chapter sets out the next steps we propose to take forward the one-year "adapted roll-over".

Question box

Question 1: Do you have any comments regarding our indicative timetable?

Responding to this document

5.1. Appendix 1 contains instructions on how to respond to this consultation document by 26 April 2010. We will publish all non-confidential responses on our website.

Next steps and indicative timetable

5.2. Our proposed way forward, as set out in the indicative timetable in table 7, is the same as we have indicated in past publications. We continue to work towards this timetable.

5.3. We intend to hold an industry workshop on the one-year "adapted roll-over" on 13 April 2010. Please contact Stuart Featham on 0207 901 7185 (or TPCR4.Rollover@Ofgem.gov.uk) if you would like to attend this event.

5.4. Following this consultation process we will consider and evaluate all comments received and will decide on the scope of the one-year "adapted roll-over". A decision on scope, including a summary of stakeholders' views, will be published in the summer.

5.5. We intend to collect both TO and SO internal cost information as part of the Business Plan Questionnaire (BPQ) process starting later in 2010 and to assess that information against their current allowances with a view to determining an allowance for 2012/13.

5.6. We then intend to publish initial roll-over proposals in mid 2011 followed by final proposals later that year so that we can implement any necessary licence changes by 1 April 2012.

Table 7 - Indicative timeline

		TPCR4 "adapted roll-over" Timeline
2010	**Spring**	Initiate internal planning for one year control Publish Scope consultation document Ofgem led stakeholder workshop
	Summer	Publish scope decision and methodology paper Issue forecast Business Plan Questionnaires (FBPQ)
	Autumn	Receipt of FBPQ responses
	Winter	
2011	**Spring**	Publish update document Issue updated FBPQ (as appropriate)
	Summer	Publish Initial proposals
	Autumn	Receive updated FBPQ responses (as appropriate)
	Winter	Publish final proposals and draft licence conditions
2012	**Spring**	Final licence conditions
	1 April	New price control period commences

Appendices

Index

Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 26 April 2010 and should be sent to:

- TPCR4.Rollover@Ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Any questions on this document should, in the first instance, be directed to:

David Hunt
Ofgem (Transmission & Governance Team)
9 Millbank
London
SW1P 3GE
0207 901 7429
TPCR4.Rollover@Ofgem.gov.uk

CHAPTER: One

No consultation questions relate to this chapter.

CHAPTER: Two

Question 1: Do you agree with the objectives for the one-year "adapted roll-over" set out in this chapter? Are there additional objectives that should be included?

CHAPTER: Three

Question 1: Do you agree with our intention to include TO and SO components in the one-year “adapted roll-over”?
Question 2: Do you agree with the three options we have identified regarding the treatment of capex? Do you agree with our ‘minded to’ position i.e. option 2?
Question 3: Do you agree with the four options we have identified regarding the treatment of opex? Do you agree with our ‘minded to’ position i.e. option 3?
Question 4: Do you support our intention not to pursue new policy issues as part of the one-year “adapted roll-over”? In particular, do you agree with our position not to assess in the “adapted roll-over” those projects that were nominated under the Enhanced TO Incentives project?
Question 5: Regarding revenue drivers, do you agree that no new regulatory incentives should be introduced and that the existing targets should be simply rolled-forward with the exception of any adjustments to address areas where there has been significant misalignment between TPCR4 baselines and outturn values?
Question 6: Do you agree with our ‘minded to’ position to extend the application of the existing network output measures methodology for the one-year “adapted roll-over”?
Question 7: Do you agree with our ‘minded to’ position to restrict licence amendments to those required to facilitate execution of the “adapted roll-over” and for any rationalisation process to take place as part of TPCR5?
Question 8: Do you agree with our proposals regarding the engagement of stakeholders? Do you have any suggestions for additional ways which we should pursue to improve stakeholder engagement?
Question 9: Do you have any further comments on the general scope of the one-year “adapted roll-over”?

CHAPTER: Four

Question 1: Do you agree with our intention to use an enhanced version of the TPCR4 financial model following developments embodied in the GDPCR and DPCR5 models for the “adapted roll-over”?
Question 2: Do you agree with our intention to use RoRE analysis for the “adapted roll-over” to ensure the package as a whole is appropriate?
Question 3: Do you agree with the three options we have identified regarding the treatment of the cost of capital and our ‘minded to’ position i.e. option 2?
Question 4: Do you agree with the two options we have identified regarding the treatment of capitalisation & depreciation and our ‘minded to’ position for option 1?
Question 5: Do you agree with the three options we have identified regarding the treatment of tax and our ‘minded to’ position i.e. option 2?
Question 6: Do you agree with the three options we have identified regarding the treatment of Pensions? Do you agree with our ‘minded to’ position i.e. option 2?
Question 7: Do you have any further comments regarding financial issues for the one-year “adapted roll-over”?
Question 6: Do you agree with the three options we have identified regarding the treatment of Pensions? Do you agree with our ‘minded to’ position i.e. option 2?

Question 7: Do you have any further comments regarding financial issues for the one-year "adapted roll-over"?

CHAPTER: Five

Question 1: Do you have any comments regarding our indicative timetable?

Appendix 2 – Background to Price Controls

1.1. This appendix provides a brief explanation of price controls.

Why do we regulate firms through price controls?

1.2. Ofgem believes that competition is the often the best mechanism to protect the interests of consumers. But there are areas of the gas and electricity industry where companies retain an effective monopoly and where it may not be possible to introduce competition. This applies to the transportation of energy to customers over national and local networks of pipes and wires. Here, incentive regulation, such as price controls are applied to protect the interests of consumers.

Who are subject to Ofgem’s price control regulation?

1.3. The 'pipes and wires' monopoly businesses are:

- National Grid Electricity Transmission for electricity transmission in England and Wales;
- National Grid Gas for gas transmission in Britain and local gas distribution in England;
- Scottish Power and Scottish and Southern Energy for high voltage and local electricity distribution in Scotland;
- The 12 companies responsible for local electricity distribution in England and Wales; and
- The 4 companies responsible for local gas distribution in England, Wales and Scotland.

What is price control regulation designed to do?

1.4. Price control regulation intends to:

- Ensure that monopolies do not abuse their position. For example, an unregulated monopoly might charge too high prices and/or provide too low quality, resulting in poor value for money for consumers; and
- Provide companies with a future level of revenue and appropriate incentives to meet their statutory duties and licence obligations.

1.5. Price control regulation provides incentives so companies can:

- manage and operate their networks in an economic, efficient and co-ordinated manner;
- offer good quality of service to customers;
- invest in their networks in a timely and efficient manner;
- help ensure long-term security of supply is maintained; and
- make any necessary changes to the networks, for example, helping development of distributed generation and increasing reductions in the amount of electricity lost on the distribution networks.

How does the price control process work?

1.6. To get the price control process right, Ofgem has to gather and analyse large amounts of information such as company financial statements and other relevant information. We use information from other sources such as customer surveys and focus groups as well as independent auditors and consultants to provide specialist help and support.

1.7. Consultation is important. Our documents give regulated companies and other interested parties the chance to comment on what Ofgem has said. Apart from written consultations, Ofgem holds discussions with companies, customer groups and other interested parties through, for example, working groups and public workshops.

1.8. The price control process is complex and normally takes between 18 months and two years to complete.

How does the price control work?

1.9. The amount of money that a monopoly business can earn on its regulated business is restricted by an RPI - X price control that is reviewed every five years. It controls prices, not profits, and encourages efficiency within the company.

1.10. The RPI - X price control takes the retail price index - the rate of inflation - as its benchmark and subtracts X - an efficiency factor - from it.

1.11. For example, at a time when annual inflation was 3 per cent, an X of 2 would allow the company to raise prices by no more than one per cent. The price control also includes incentive mechanisms to encourage companies to deliver what customers require. For example, companies can be rewarded or penalised depending on the quality of service they deliver.

1.12. Price controls provide a company with a level of revenue that is enough to finance an efficient business. This is based on an estimate of the costs companies face in running their business. These include:

- Operating expenditure - this covers the day-to-day costs of running the network, such as staff costs, repairs and maintenance, overhead costs etc. An allowance is made to cover the amount of operating expenditure which an efficient company would be expected to incur over the price control period;

- Capital expenditure - this covers spending on assets, such as overhead lines, underground cables and other plant. A projection is made of the level of capital expenditure that an efficient company would incur over the price control period. The benefits of capital expenditure are expected to last over several years so companies recover these costs over the assumed life of the asset;

- Financing costs - this covers the costs an efficient company may be expected to incur in providing a reasonable return to the investors who provide the capital and other financial facilities it requires; and

- Taxation - the price control must provide sufficient cashflow to cover the tax liabilities that an efficient company may be expected to incur, taking into account, for example, the current rate of corporation tax.

How is Ofgem looking to develop price controls?

1.13. The RPI-X framework is currently under review as part of our RPI-X@20 project. Appendix 3 provides more detail on this project.

Appendix 3 – Background to RPI-X@20

Introduction

1.1. This Appendix provides more information on the RPI-X@20 project. More information, including recent publications, can be found on the RPI-X@20 pages of the Ofgem website[17].

1.2. Our 'RPI-X@20' review - a major two year project and a key area of interaction with our work on the "adapted roll-over" – was initiated by Ofgem in March 2008. It is reviewing the workings of the current approach to regulating GB's energy networks and developing recommendations for future policy.

1.3. The conclusions of the RPI-X@20 project will be implemented in the next full price control, TPCR5, on 1 April 2013. However, where there are areas of work we could undertake within the one-year "adapted roll-over" which would smooth the path of TPCR5 but which will be independent of the conclusions from the RPI-X@20 project, we intend to do so.

The rationale underpinning RPI-X@20

1.4. While we recognise that RPI-X regulation has delivered significantly lower prices, better service quality and better network reliability since its implementation, we think that it is prudent to undertake a review now for a number of reasons. First, as a matter of good housekeeping, it is right that after 20 years we assess whether the approach remains fit for purpose. Second, the challenges faced by the energy industry have changed, with the emphasis now on facilitating efficient investment to achieve environmental targets and ensure security of supply as well as on the achievement of efficiency gains. Finally, over time RPI-X has become more complex and, if possible, it may be beneficial to simplify the framework to allow customers and companies to effectively engage in price control processes.

Guiding principles for RPI-X@20

1.5. We don't intend to implement change for changes sake and amendments to the current regime will only be made where there are clear benefits. There are a number of further guiding principles to which we are following as part of the RPI-X@20 project including:

- **Consultation:** We are consulting widely with stakeholders through a range of forums including stakeholder workshops, meetings and formal consultation documents. Also through other methods such as the web forum we have developed which provides stakeholders with the opportunity to post papers or thoughts regarding the RPI-X@20 project on the Ofgem website and through

[17] http://www.ofgem.gov.uk/Networks/rpix20/Pages/RPIX20.aspx

the working groups that were established. The use of this range of consultative tools allows stakeholders many opportunities to engage in and contribute to the overall review.

- **Transparency:** We are being transparent in the way we undertake this project and will continue to do so in the way we arrive at conclusions and recommendations. Our consultative approach should help to facilitate this.

- **Better Regulation:** We are following a process and intend our conclusions to be consistent with the Better Regulation principles

- **No surprises:** We are adopting a transparent approach to the RPI-X@20 project to ensure that stakeholders are aware of the direction of Ofgem’s thinking and the rationale that will underpin the recommendations that we take to the Authority. There should not therefore be any surprises for stakeholders.

- **No retrospective action:** We understand the importance of maintaining regulatory certainty and therefore are keen to make clear that the RPI-X@20 project will be focussed upon the framework for future regulation of energy networks rather than reconsideration of any decisions taken in the past.

- **No stranding of efficient investment:** Where efficient investment has been undertaken by network companies, suitable funding arrangements will be incorporated within any framework that may be adopted following the recommendations of the review.

Progress of RPI-X@20

1.6. The Emerging Thinking document set out our intention to design a new regulatory process for price control reviews that is more streamlined, accessible and transparent. The proposed new regulatory framework would encourage network companies to focus on the longer term and:

- Play a much greater role in facilitating the delivery of a sustainable energy sector whilst continuing to facilitate competition;
- Deliver continuous, long-term improvements in outputs and efficiency;
- Take more responsibility for developing solutions that are best value for present and future consumers;
- Manage uncertainty, taking on risk where appropriate and keeping options open where cost effective;
- Engage more effectively with all stakeholders, responding to existing and anticipated needs of consumers of network services; and
- Be more innovative, looking for new and better ways of delivering and adapting over time as they learn what works best.

1.7. We published our ‘Principles, Process and Issues’ consultation paper in February 2009. Since then we have published a number of working papers in different policy areas designed to inform on our early thinking and provoke debate. We have also published a number of consultant reports and other materials. We will continue to engage with stakeholders and interested parties as our thinking progresses. Our final recommendations will be made to GEMA in summer 2010 and a decision consulted on in Autumn 2010.

Appendix 4 – 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.[18]

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[19].

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 existing and future consumers, 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[20];
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.[21]

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:

[18] entitled 'Gas Supply' and 'Electricity Supply' respectively.
[19] 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.
[20] 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.
[21] The Authority may have regard to other descriptions of consumers.

- promote efficiency and economy on the part of those licensed[22] 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; 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[23] 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.

[22] or persons authorised by exemptions to carry on any activity.
[23] Council Regulation (EC) 1/2003

Appendix 5 - Glossary

B

Baseline

Baselines define the reference levels of capacity that the gas transmission licensee is to release. Baselines also determine the levels above (or below) which incremental capacity is defined.

Baseline Capital Expenditure

Baseline capital expenditure is the total amount of capex required in association with the baseline. It includes both load related capex and non-related capex.

British Electricity Trading and Transmission Arrangements (BETTA)

BETTA introduced a single GB-wide set of arrangements for trading energy and for access to and use of the electricity transmission system which came fully into effect at BETTA go-live (1 April 2005).

Buy Back

NGG NTS in operating the NTS may find itself in a position where it expects it cannot deliver firm NTS entry capacity that it has previously sold at the various auctions, for example when there are temporary physical constraints on the NTS. In this situation it may buy some of the NTS entry capacity back that it has previously sold in order to meet its obligations, this is known as buy back.

C

Capital Expenditure (capex)

Expenditure on investment in long-lived transmission assets, such as gas pipelines or electricity overhead lines.

D

Distribution Price Control Review (DPCR5)

The price control review for the electricity distribution network operators. The resulting price control covers the years 20010 to 2015.

Distribution Network Operators (DNOs)

Holders of electricity distribution licences. Licences are granted for specified geographical areas. Currently in Great Britain there are seven companies who own the fourteen licensed distribution areas.

E

Early Retirement Deficiency Costs (ERDC)

ERDCs are the costs of providing the additional pension benefits payable to a scheme member who retires before normal retirement date as a result of re-organisation or redundancy, over and above the benefits to which such a member would be entitled if he retired voluntarily at the same date. The rules of both the ESPS and the LGPS provide for the automatic enhancement of benefits to which a member becomes entitled on taking early retirement as a result of re-organisation or redundancy. Principal employer companies have often in the past used a pension fund surplus to cover part or all of these additional costs, subject to agreement with the trustees of the scheme. In the absence of agreement by the trustees, the employer must make additional contributions to the pension fund to cover the additional liability.

Electricity Supply Pension Scheme (ESPS)

A Retirement Benefit Scheme based upon benefits paid as a proportion of final salary. The Scheme is an exempt approved scheme (ICTA’88) and is subject to a trust document. The ‘Group’ has many principal employers and is organised and defined by a set of rules, trustees and produces accounts annually and actuarial valuations at least every 3 years (triennially). The scheme is principally for people working in the Electrical Utility Industries. This scheme is one of the 26 separate tranches each actuarially independent.

European Union Emissions Trading Scheme (EU ETS)

The EU ETS is a market based mechanism for the reduction of carbon emissions. It is a cap and trade scheme designed to reduce the level of emissions at an EU wide level through the trading of emissions permits.

F

Forecast Business Plan Questionnaire (FBPQ)

Expenditure information requested by Ofgem from the licensees relating to the period from 2005/06 to 2011/12.

G

Gas Distribution Networks (GDNs)

Gas Distribution Networks, of which there are eight, four of which are owned by National Grid Gas plc, and four of which were sold by Transco plc (now National Grid Gas plc) on 1 June 2005 and are now owned by Scotia Gas Networks, Southern Networks, Northern Gas Networks and Wales and West Utilities.

Gas Distribution Price Control Review (GDPCR)

The review of the price control applying to gas distribution networks. The latest GDPCR covers the period from 2007 to 2013.

I

Innovation Funding Incentive (IFI)

A mechanism to remunerate research & development expenditure by DNOs.

K

K-factors

Correction factors to account for the under or over-recovery of revenues between years of the price control.

L

Liquefied Natural Gas (LNG)

LNG consists mainly of methane gas liquefied at around -260 degrees Fahrenheit. Cooling and liquefying the gas reduces its volume by 600 times such that a tonne of LNG corresponds to about 1,400 cubic metres of methane in its gaseous state. LNG may be stored or transported by special tanker.

Load Related Capex

The installation of new assets to accommodate changes in the level or pattern of electricity or gas supply and demand.

N

National Electricity Transmission System Operator (NETSO)

See ‘System Operator (SO)’.

National Grid Gas (NGG NTS)

The licensed gas transporter responsible for the gas transmission system, and four of the regional gas distribution companies.

National Grid Electricity Transmission (NGET)

The electricity transmission licensee in England & Wales.

National Transmission System (NTS)

The high pressure gas transmission system in Great Britain.

Non-Load Related Capex

The replacement or refurbishment of assets which are either at the end of their useful life due to their age or condition, or need to be replaced on safety or environmental grounds.

O

Operating Expenditure (Opex)

The costs of the day to day operation of the network such as staff costs, repairs and maintenance expenditures, and overhead.

Operating Margin (OM)

In relation to gas the OM is gas in storage which is reserved by the NTS to ensure the supply of gas is maintained in the event of a network emergency.

R

Regulatory Asset Value (RAV)

The value ascribed by Ofgem to the capital employed in the licensee's regulated transmission or (as the case may be) distribution business (the 'regulated asset base'). The RAV is calculated by summing an estimate of the initial market value of each licensee's regulated asset base at privatisation and all subsequent allowed additions to it at historical cost, and deducting annual depreciation amounts calculated in accordance with established regulatory methods. These vary between classes of licensee. A deduction is also made in certain cases to reflect the value realised from the disposal of assets comprised in the regulatory asset base. The RAV is indexed to RPI in order to allow for the effects of inflation on the licensee's capital stock. The revenues licensees are allowed to earn under their price controls include allowances for the regulatory depreciation and also for the return investors are estimated to require to provide the capital.

RPI-X

The form of price control currently applied to network monopolies. Each company is given a revenue allowance in the first year of each control period. The price control then specifies that in each subsequent year the allowance will move by 'X' per cent in real terms.

Re-openers

A process undertaken by Ofgem to re-set the revenue allowances (or the parameters that give rise to revenue allowances) under a price control before the scheduled next formal review date for the relevant price control.

Revenue Driver

A means of linking revenue allowances under a price control to specific measurable events which are considered to influence costs. An example might be to allow a specified additional revenue allowance for each MW of new generation connecting to the network. Revenue drivers are used by Ofgem to increase the accuracy of the revenue allowances.

S

Safety net

A mechanism that would trigger a review of allowances in the event of a major shortfall of investment relative to allowances.

Security and Quality of Supply Standard (SQSS)

As referred to in the electricity Transmission Licence Standard Conditions C17 and D3, this is the standard in accordance with which the electricity transmission licensees shall plan, develop and operate the transmission system.

Scottish Hydro-Electric Transmission Limited (SHETL)

The electricity transmission licensee in northern Scotland.

Scottish Power Transmission Limited (SPTL)

The electricity transmission licensee in southern Scotland.

Sliding scale

This term is used generically to describe incentive schemes which involve profit (and loss) sharing around a fixed target costs, such as the current form of SO incentives in gas and electricity.

Sulphur Hexafluoride (SF6)

A potent greenhouse gas frequently used in electrical equipment.

System Operator (SO)

The system operator has responsibility to construct, maintain and operate the NTS and associated equipment in an economic, efficient and co-ordinated manner. In its role as SO, NGG NTS is responsible for ensuring the day-to-day operation of the transmission system.

T

Total Cost Allowance (TCA)

Is the Unit Cost Allowance multiplied by the number of units.

Transmission Connected Customer (TCC)

A customer directly connected to the gas or electricity transmission system.

Transmission Entry Capacity (TEC)

Defines a generator's maximum allowed export capacity onto the transmission system. The holder of the TEC has the right to export the specified number of megawatts onto the transmission system at any one time, and is eligible for compensation if NGET cannot accommodate this export on the network.

Transmission Investment for Renewable Generation (TIRG)

The regulatory mechanisms developed before the start of TPCR4, to fund a number of specific network enhancement projects required to provide transmission capacity for new renewable generation plants.

Transmission Owners (TO)

Companies which hold transmission owner licenses. Currently there are three electricity TOs; NGET, SPTL and SHETL. NGG NTS is the gas TO.

Transmission Price Control Review (TPCR)

The TPCR will establish the price controls for the transmission licensees which will take effect in April 2007 for a 5-year period. The review applies to the three electricity transmission licensees, NGET, SPTL, SHETL and to the licensed gas transporter responsible for the gas transmission system, NGG NTS

True up

This is the adjustment for the difference between the allowance and the actual expenditure in the previous price control.

U

Uniform Network Code (UNC)

As of 1 May 2005, the UNC replaced NGG NTS's network code as the contractual framework for the NTS, GDNs and system users.

V

Vesting Assets

Assets included in the RAV at the vesting date.

Vesting

The date at which the regulated gas and electricity transmission and distribution companies were privatised.

Vanilla Weighted Average Cost of Capital (Vanilla WACC)

The weighted average cost of capital using a pre-tax cost of debt and a post-tax cost of equity.

W

Weighted Average Cost of Capital (WACC)

The weighted average of the expected cost of equity and the expected cost of debt.

Appendix 6 - 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:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report’s conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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